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VIEWS FROM THE BRICK

ENTER THE 200-DAY

The year has proven to be an exceptionally interesting time to be alive in the global capital markets that, up until the start of October, saw very strong, above average paced U.S. equity market returns. But the rest of the world was left behind as foreign developed and emerging market equities had entered correction and bear market territory before the summer was over. The start of the fourth quarter has proven to snap U.S. equities back to reality, as the S&P 500 has contracted by more than 7% in the month, bringing the YTD returns for the index to less than 3% in gains. Just three weeks ago (September 28), the YTD return was 10.5%[1]. As the most widely tracked U.S. index barrels its way into correction territory (for the second time this year) it's important for us to understand that what we've seen up until this point for this year is still statistically normal.

SINGLE-DAY MOVES

Dating back to 1928, the S&P 500 has experienced an average of three single -3% daily moves in a calendar year. This week we saw the fourth for the year. Since 1964, the S&P 500 has ended October down by at least 5% four separate times (1978, 1979, 1987 and 2008). In two of those occurrences, the following November was positive. In all four of those cases, the following December was positive[2].

Last year's abnormally docile environment (just nine single-day moves of at least 100 basis points; two standard deviations from the long-term mean) has successfully lulled investors to sleep. The return of volatility, albeit sporadic, this year has forced investors to reassess their capacity and tolerance for true equity behavior. So far (through October 25) we've recorded 48 single day 100 basis point moves, registering as the highest reading since 2015's 72 sessions outside the band[3].

SOURCE: This presentation is solely for informational purposes and should not be taken as investment advice. For further information, please contact one of our investment adviser representatives. [1] Bloomberg. [2] Bloomberg. [3] Bloomberg.

DEAD CATS

We actually believe that the scar tissue from 2017 is setting up to have a more lasting impact on investor psyche than 2008. Investors can easily get tricked into believing the volatility regime change means that all recoveries are V-shaped, and that the market is bullet proof. But here's some food for thought from @oddstats:

> *"Since 1950, there have been 22 occasions that the S&P dropped by at least -3% one day and then was up at least 2% the next day. The average intraday drawdown over the next 5 trading days (from the market close of the +2% day) was -5.1%."*

Avoiding the dead cat bounce is a tricky game investors partake in when trying to catch a falling knife. So what can we do in order to try to keep an eye on the long term while respecting the immediate pickup in volatility? Enter the 200-day moving average.

BRING DA RUKUS

Everybody is a market technician on the way down, and everybody is the next Buffett (or quant, these days) on the way up. Wednesday marked the fourth consecutive close below the 200-day moving average for the S&P 500. This hasn't occurred since March of 2016, when we were in a widely range-bound, trendless market environment. Earlier this year, the S&P 500 closed below the moving average as well. This was the first day in more than two years at the time[4]. Historically, stocks have traded below the 200-day just one-third of the time dating back to 1928. The volatility of all trading days spent below the average has been close to 75% higher than days spent above it[5].

The final three intangibles we think these winners possess are patience, conviction and a competitive mentality. Possessing the patience to not act when Mr. Market is doing his best to force your hand, is paramount. We think patience and conviction are nearly two in the same. Buffett has been known to make reference to Ted Williams, one of the greatest baseball players of all time. Williams' ability to hit a baseball has gone unmatched even through the modern era on many levels. Ted Williams was the last player to hit .400 over the course of an entire season in 1941. He did it by going 6-8 in a double header against Philadelphia on the final day of the season.

Over the last 90 years, the daily return of the S&P 500 when below the 200-day has been -0.11% with a standard deviation of 25%. Compared to the time spent above the average, where returns came in at 0.09% and a standard deviation of 14.6%[6].

What's the moral of the story? Nothing good ever happens below the 200-day. Conceptually, just think about what the 200-day moving average tells you. If the average price of the index for the last year (+/-) is higher than today's price: investors aren't convinced that tomorrow will outpace where we just came from.

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GHOSTS OF VOLATILITY PAST

If 90-or 60-year statistics are too long-term for your taste, we don't think you need to look too far past 2015 to draw some stark comparisons to today's environment. Here's a quick recap of the macro environment from August 2015-March 2016: China concerns, rising rates, algorithmic trading-inspired moves and recession whispers.

We think all of those points have made their way into headlines in the last week alone. The last time this noise Molotov cocktail was put together we saw a stretch of 94/142 trading days below the 200-day and experienced a marginally net negative price return by the end of it[7]. That was probably the best thing that could have happened at the time. We're not saying this is the blueprint we're going to follow, but usually without substantial evidence, the visits below the moving average are head fakes, not the start of a prolonged bear market. Some stays are longer than others though (cue Hotel California).

We anticipate the human nature of investors to continue to fall in line with this historical data moving forward. Trends below their moving average are often times unhealthy, erratic and unstable conditions to be investing in. The length of stay below water is never consistent, but we do know without tangible evidence of an economic slowdown around the corner, that the surface shouldn't be far out of reach.

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