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INVESTMENT MANAGEMENT

Mitch on the Markets

Time to Buckle Up for Volatility in October!

By Mitch Zacks
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Black Monday took place on October 19, 1987. Many readers probably remember it vividly. The stock market plummeted over 20% in a flash – the Dow Jones Industrial Average fell 22% in one day and the S&P 500 lost 28.5% of its value between October 14 and 19. The total loss of wealth over that period was approximately $1 trillion, according to a Presidential Task Force report on the crash.

So, why am I telling you this now? It's not to give you worry or pause, and I do not think there is even a remote chance we will see that type of crash again this October (or anytime soon for that matter). I'm telling you this now for two reasons: 1) to remind you that significant pullbacks can and do happen, and they are especially prone to stock markets that have risen steadily over long periods of time; and 2) because this week I'm writing about October being a historically volatile month, and I think it's important for investors to always be prepared for volatility so you're never caught off guard.

Bumpy Rides in October

Over the past 100 years, October has proven to be, on average, the most volatile month on the calendar. The data used to determine the level of volatility is the standard deviation of the Dow's daily percentage changes for each month. Looking at that metric, October comes in at 1.44%, which is materially higher than the 1.08% average across all twelve months taken together. What's more, even if you exclude the most volatile October ever (1987), it still ranks as the highest volatility month.

Of course, the fact that October has historically been the most volatile month does not mean it is always the most volatile, and it certainly does not imply that October will be the most volatile month of 2017. But, the statistics at least offer us a good reason to remember that volatility can and does rear its head when many investors least expect it. And, given that 2017 has been a year of low volatility and solid returns, many investors are arguably getting a bit too comfortable in their view of the markets. If volatility erupts like a

volcano, hopefully reading this column will remind you to stay cool – volatility is a normal, natural feature of equity investing, and in my opinion it's overdue at this stage in the bull market.

As long as we're leaning on history to provide us some insight and lessons about investing, let's consider two other historical facts. The first is that October, while historically being the most volatile month, is *not* the worst performing one. How could that be?

The answer is simple, and it's a truism of investing that we often forget and/or overlook: *because volatility works both ways.* When I wrote that October is historically the most volatile month, many readers likely took that to mean that it experiences the most downside of any month on the calendar. Not so! There is downside volatility *and* upside volatility, and the most volatile month of the year is certain to experience both types. Octobers throughout history are no exception.

The second history lesson brings us back to 1987. Even though the market crashed in terrifying fashion and sent many investors running for the hills, many people don't appreciate that the S&P 500 *still finished the year in positive territory.* The declines were rapid and steep, but so was the 'v-shaped bounce' that saw prices soar higher. The recovery stocks experienced then was textbook volatility, even though most people would think the volatility only applied to the steep declines that characterize October 1987.

Bottom Line for Investors

In 1987, investors with a steady hand and a patient approach likely did the best. After all, the S&P 500 finished the year up 5.81%, even though it fell over 20% in just five trading days in October.

Think about that for a moment: if the market were to collapse 20% in just five days later this month or sometime in the near future, *would you keep your cool and stay invested?* The answer to that question, in many circumstances, is what separates the long-term successful investor from the investor who is constantly frustrated with returns.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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