ZACKS INVESTMENT MANAGEMENT

Mitch on the Markets

Is Volatility Truly Gone from the Market?

By Mitch Zacks
Portfolio Manager

The wild stock market gyrations of early February have given way and seemingly left market participants with an overall feeling of renewed price stability. We believe that at least for now, investors can think clearly again.

With the markets experiencing a relative calm (again, for now), I'd like to offer up this suggestion to readers and investors alike: *please take this moment to re-examine how you dealt with the recent market correction. What was your psychology during the downturn? What can you learn from the experience?*

For many, the gut feeling to sell stocks was pronounced, perhaps even irresistible. But 'reacting' would have meant ignoring the economic fundamentals that, in our view, did not change and continue to point to more growth ahead. Reacting during the correction could have also meant prioritizing short-term sentiment over long-term goals, which flies directly in the face of what many investors are truly trying to achieve.

But, there is another facet of investor psychology that is ultimately more personal than it is financial. That is, did you put yourself through undue stress by latching onto the hysteria swirling around the selloff? Was that really necessary?

Taking stock of how we responded to market volatility and the sell-off can provide us insights into our strengths and weaknesses as investors. It might even make sense to make a few notes, document how you felt, how you reacted, and what you would have done differently with the benefit of hindsight. When future corrections come – and there will be many – you should be better equipped to handle them.

Now that investors can "think clearly" again, let's forget about technical price gyrations for a moment and re-focus on fundamentals. One of Zacks Investment Management's favorite places to look: corporate earnings.[1]

A Case for Further (or Renewed) Optimism: Look at Corporate Earnings

For the 341 S&P 500 companies that have reported results so far, total earnings are up +14.7% from the same period last year on +9.3% higher revenues. 78.6% of those companies have exceeded earnings per share (EPS) estimates, and 76.8% have exceeded revenue estimates. If these feel like solid figures, it's because we believe they are – these figures mark an above-average proportion of companies beating top and bottom-line expectations. What's more, the proportion of companies beating both EPS and revenue estimates is 63.6%.

Looking at Q4 as a whole, combining the actual results from the 341 index members with estimates from the still-to-come 159 companies, total earnings are expected to be up +14.1% from the same period last year on +8.2% higher revenues. This would follow +6.7% earnings growth in Q3 2017 on +5.8% revenue growth. If the Q4 figures shake-out like we think they could, we could see the highest quarterly growth rate in years! And as if that weren't enough, earnings estimates for the current period are also going up materially.

Bottom Line for Investors

The deeper we examine the recent market activity, the more we are convinced that the selloff was almost entirely technical in nature. Economic fundamentals did not change over the last few weeks as far as we can see, and earnings have been coming in strong relative to past periods and expectations.

Instead, what we think we saw was a mini-onslaught of triggered selling from various systematic, automated strategies. In particular, the selling strategies that used realized volatility, correlations, VIX and price momentum as signals to adjust exposure. These strategies have attracted a considerable amount of new assets over the last decade or so, and when sell signals are triggered so abruptly it can lead to a liquidity squeeze on the other side of the trade. In other words, selling that is largely unrelated to concerns about earnings, growth, and profits – the factors that we believe matter most.

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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