Mitch on the Markets

Volatile Market Causes Many Investors to Miss January Rally

By Mitch Zacks
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We're only in the second month of the new year, but already we've seen many investors experience the tragic cost of market volatility.

According to Lipper data, investors moved a staggering $190 billion into money market funds (cash) in Q4 2018. The last time investors fled risk assets in such large numbers was during the 2008 global financial crisis.[1]

With the benefit of hindsight, we know that the decision to go to cash in Q4 2018 likely came at a steep – what I call 'tragic' – cost. Since Christmas Eve, when the S&P 500 touched bear market territory with a ~20% decline from September highs, the market has rallied strongly: up +12.05% through last Friday, February 8. January 2019 delivered the best rally to start a new year in over 30 years.[2]

But for investors who went to cash in Q4, I wonder how many of them sold when the market was at or near the bottom, and I also wonder how many investors either 1) remain on the sidelines today as a result; or 2) got back into stocks only partway through the current rally. Neither outcome seems desirable to me.

But there's still more to consider when it comes to the current rally, the biggest being the possibility that investors who missed the upsurge may not get much of a second chance. This bull market is now in its 10th year, and all signs point to overall slower global economic growth and fading corporate earnings growth. Q1 2019 is already looking like it could be a flattish period for earnings growth, and full-year 2019 growth is expected in the mid-single digits – a far cry from 2018.[3] In my view, there's a reasonable argument that a healthy bulk of expected returns for 2019 have already happened, and investors may realistically expect modest returns for the balance of the year.

The make or break catalyst for bears and bulls alike seems to be the China trade deal and Fed policy. Both have the potential for positive and negative surprises, and both could determine the arc of GDP and earnings growth for 2019. As it stands today, 2019 annual GDP growth consensus is at +2.7% while earnings consensus is at +7.9% annual growth. A failed China trade deal and a messy Brexit could impact both to the downside, but the opposite could also hold true. Investors should expect another patch of volatility as these issues get sorted, and I'll use history to explain why a patient approach this time around may be warranted.

History Supports a Patient Approach to Market Volatility

Our Chief Equity Strategist at Zacks Investment Research, Dr. John Blank, recently detailed just how quickly and compellingly stocks can rebound following corrections. He noted that since 1926, stocks rose an average of +34% before dividends in the 12-month period following a correction (when stocks fall 10% - 20%). After bear markets, when stocks decline 20% or worse from a recent peak, the next 12-months average 47%.

The takeaway from this data is one that we've known all along – equity markets tend to rebound just as quickly as they decline, often whipsawing investors who try to time entry and exit. A steady approach may mean absorbing some of the losses on the downside, but it also means participating in the gains when the market quickly recovers. So far, it always has.

Bottom Line for Investors

Considering that the recent equity swings occurred over a relatively short period of time, I'm not sure the market timers fared so well. In my view, during the throes of the market correction, a better decision would have been to remain calm and patient, resisting the urge to react to downside volatility by making wholesale changes to a portfolio's asset allocation. It's the line we held here at Zacks Investment Management, and I think it was the right decision.

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.

[1] Forbes, February 1, 2019. https://www.forbes.com/sites/michaelcannivet/2019/02/01/without-pain-theres-no-gain-in-the-stock-market/#5d997715198c
[2] Yahoo Finance, February 12, 2019. https://finance.yahoo.com
[3] CNBC, February 5, 2019. https://www.cnbc.com/2019/02/05/goldman-sachs-if-you-missed-the-january-rally-you-likely-missed-the-2019-gain.html

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