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We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

The recent turbulence in the stock market doesn't warrant the white-knuckle treatment

2017 was an outlier with respect to volatility

In 2017, a survey by Natixis Global Asset Management found that help with managing market volatility was the sixth most frequent request that investors had for their financial advisor. Ironically, volatility in the stock market plunged to an all-time low in 2017, so there wasn't much to manage. That is no longer the case in 2018. Volatility is back. The good news is that it still clocked in below its historical norm in Q1'18.

Perhaps the most well known measure of volatility in the stock market is the so-called VIX Index, which is short for the CBOE SPX Volatility Index®. It uses S&P 500 Index options activity to gauge investors' expectations of volatility. It represents a 30-day measure. It is often referred to as the "fear index" by the financial media. Over the past 10- and 20-year periods ended 3/29/18, the VIX Index averaged 19.87 and 20.34, respectively, according to Bloomberg. As we noted, the VIX Index registered its all-time closing low last year at 9.14 (11/3/17). It averaged just 11.09 for the full year. In Q1'18, its average reading spiked to 17.25, still below its longer-term historical averages.

One of the reasons why so much attention is being focused on volatility levels in 2018 is that the rise in volatility was accompanied by a stock market correction (a price decline of 10% or more) in the S&P 500 Index. The 10.10% correction in the S&P 500 Index from its all-time high on 1/26/18 through 2/8/18 was met by a surge in the VIX Index, from a reading of 11.08 at the close on 1/26/18 to as high as 37.32 at the close on 2/5/18, according to Bloomberg. While the surge in volatility is understandable when you factor in the correction, seeing the VIX Index readings trending back to normal levels should actually reassure investors that the checks and balances of the stock market are alive and well, in our opinion. If you recall, the tone of the financial media's coverage of the historically low volatility levels in 2017 was one of concern and not reflective of a healthy market. The focus of the discussion was about how complacent investors had become.

The table at the upper right of this page tells the story. Volatility swings both ways. Begin by comparing the VIX Index levels posted in 2008 and 2009, which encompassed the financial crisis. In both years, the average readings were significantly higher at 32.69 and 31.48, respectively, than the historical norm of around 20.00, yet the total returns posted by the S&P 500 Index were nothing alike. The data in the table also shows that the S&P 500 Index can prosper even when the average on the VIX Index is north of 20.00 (see 2003 & 2010).

Another gauge of volatility getting some press lately is the size of the daily fluctuations of the major stock indices. In 2016 and 2017, the S&P 500 Index registered several multi-month periods without experiencing a single up or down day of more than 1%, according to Bloomberg. As of Q1'18, there have already been 23 days in which the S&P 500 index has fluctuated by more than 1% in a trading day, more than triple the total for all of 2017. Suffice it to say, volatility has replaced complacency, and that is a good thing, in our opinion.

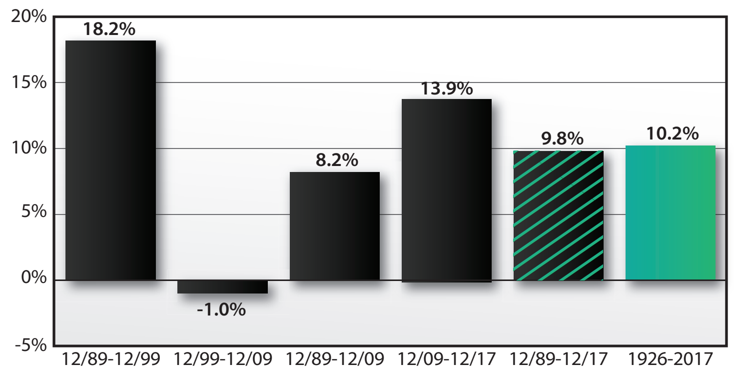
Annual and Q1'18 change in CBOE SPX Volatility Index® (VIX) and S&P 500 Index Total Returns

Year	VIX High	VIX Low	VIX Average	S&P 500 Total Return
2003	34.69	15.58	21.98	28.68%
2004	21.58	11.23	15.48	10.88%
2005	17.74	10.23	12.81	4.91%
2006	23.81	9.90	12.81	15.79%
2007	31.09	9.89	17.54	5.49%
2008	80.86	16.30	32.69	-37.00%
2009	56.65	19.47	31.48	26.46%
2010	45.79	15.45	22.55	15.06%
2011	48.00	14.62	24.20	2.11%
2012	26.66	13.45	17.80	16.00%
2013	20.49	11.30	14.23	32.39%
2014	26.25	10.32	14.18	13.69%
2015	40.74	11.95	16.67	1.38%
2016	28.14	11.27	15.83	11.96%
2017	16.04	9.14	11.09	21.83%
Q1 2018	37.32	9.15	17.25	-0.76%

Source: Bloomberg. Past performance is no guarantee of future results.

In addition to the recent spike in volatility, one of the other critiques of the stock market is that it is overvalued, even after the correction in Q1'18. We address this on page two. For those investors who fear that stocks are overvalued, we offer the chart below. While there are many metrics that can be used to argue one side or the other, we believe there is room for an eyeball test using historical returns. The second bar in the chart illustrates how poorly stocks performed following the outsized returns of the 1990s (internet revolution). The S&P 500 Index has been playing catch up to its historical average annual total return (1926-2017) of 10.2% ever since, as evidenced by the 9.8% average annual total return from 12/89-12/17. While stocks are not cheap at current levels, we do not believe they are overvalued.

S&P 500 Index Average Annual Total Returns



Source: Bloomberg & Ibbotson Associates/Morningstar. Past performance is no guarantee of future results.

Comparing the 2nd longest bull market in history to the longest

The current bull market in stocks just turned nine years old in March. At 3,309 days (3/9/09-3/31/18), it ranks as the second-longest bull market ever, according to Bespoke Investment Group. The longest bull market lasted 4,494 days (12/4/87-3/24/00). That means that the current bull market has another 1,185 days to run to match the longest on record, or 3.25 years. While we acknowledge that the current bull market is a bit long in the tooth, we believe it still has legs. So we thought it would be interesting to compare the two longest bull markets in history to see where some key market and economic fundamentals stood at the 3,309-day mark (see table).

Believe it or not, the current bull market in stocks is the "most hated" of all time, according to MarketWatch. That is an amazing claim when you consider that the S&P 500 Index (the "index") posted a cumulative total return of 372.06% over the 3,309 days. That topped the index's 340.99% cumulative total return generated over the same time frame in the longest bull market. The index then went on to post a cumulative total return of 841.12% (highest return of any bull market) over the entire 4,494 days. Keep in mind that the latter stages of the longest bull market was largely driven by the internet revolution. Data from the Investment Company Institute (ICI) indicates that retail investors in the U.S. liquidated a net $615.12 billion from equity mutual funds from 2009 through 2017. That lends some credence to the "most hated" moniker. Over that same span, investors funneled a net $1.34 trillion into bond mutual funds. ICI data paints a different picture with respect to fund flows during the longest bull market. Retail investors poured a net $1.58 trillion into equity mutual funds from 1988 through 2000, compared to net inflows totaling $188.33 billion for bond mutual funds.

On a price-to-earnings (P/E) basis (see table), the companies that comprise the S&P 500 Index were more expensive in the current bull market on day 3,309, as might be expected when you factor in the outperformance. For comparative purposes, over the past 50 years, the average P/E on the index was 16.73, according to Bloomberg. At the conclusion (March 2000) of the longest bull market, the P/E on the S&P 500 Index stood at 28.91.

Perhaps the biggest takeaway from the table pertains to the disparities in the federal funds target rate (upper bound), the yield on the 10-year Treasury note and inflation (CPI). All three of these metrics stood well below their respective levels in the longest bull market after 3,309 days. Such favorable readings bolsters the prospects for the current bull market moving forward, in our opinion.

As indicated in the table, real U.S. GDP growth and capacity utilization rates (plants and factories) were notably higher in the longest bull market. Capacity utilization rates above 80% tends to signal there is a healthy demand for goods. In addition to reducing the federal tax rates on corporations and individuals, one of the overarching goals of the Tax Cuts & Jobs Act passed into law on 12/22/17 is to accelerate U.S. economic growth. The tax cut for individuals was expected to be reflected in their paychecks as early as February. If tax reform is successful in boosting economic growth moving forward, we believe the current bull market can carry on.

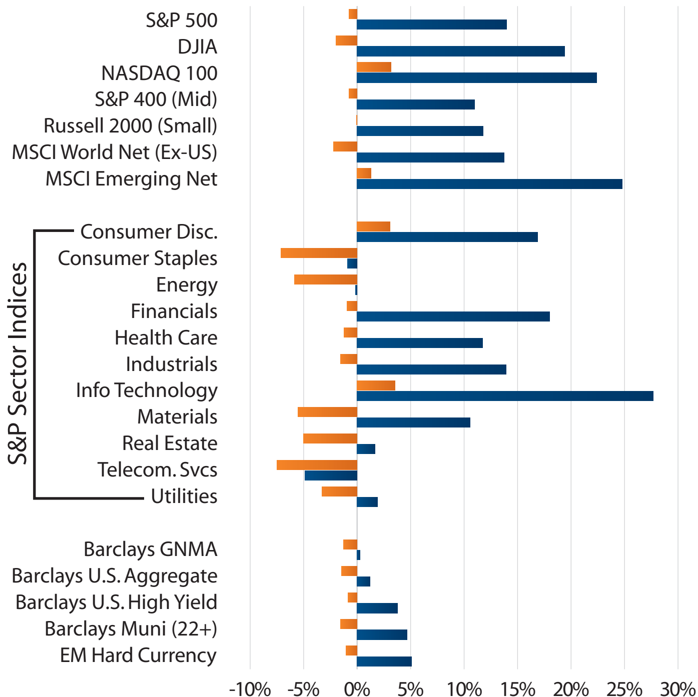
Two Longest U.S. Equity Bull Markets

(3,309 days into bull market)

Key Statistics/Indicators	Current Bull *(3/9/09-3/31/18)*	Longest Bull *(12/4/87-12/25/96)*
S&P 500 Index Cumulative Total Return	372.06%	340.99%
S&P 500 Index Trailing 12-Mo. P/E Ratio	21.19 *(3/30/18)*	19.01 *(12/31/96)*
S&P 500 Index Dividend Yield	1.95% *(3/30/18)*	1.97% *(12/31/96)*
Federal Funds Target Rate *(Upper Bound)*	1.75% *(3/30/18)*	5.25% *(12/24/96)*
Federal Reserve Balance Sheet	$4.39 Trillion *(3/28/18)*	$475.00 Billion *(12/25/96)*
Yield on 10-Year Treasury Note	2.74% *(3/29/18)*	6.34% *(12/24/96)*
CPI Headline Rate	2.4% *(3/31/18)*	3.3% *(12/31/96)*
Consumer Confidence Index *(Conference Board)*	127.70 *(3/31/18)*	114.25 *(12/31/96)*
Unemployment Rate	4.1% *(3/31/18)*	5.4% *(12/31/96)*
Real U.S. GDP Growth Rate *(Annualized)*	2.9% *(Q4'17)*	4.3% *(Q4'96)*
Capacity Utilization (Industrial)	*77.66% (2/28/18)*	*83.59% (12/31/96)*

Sources: Bloomberg and Bespoke Investment Group. Past performance is no guarantee of future results.

Total returns for *Q1* and past 12 months (3/29/18)



Sources: Bloomberg and Barclays. Past performance is no guarantee of future results.

A Look Ahead:

A year-over-year earnings comparison in U.S. dollar terms. The S&P 500 Index dollar figures reflect the 11 major sectors on a weighted-adjusted basis.

Index (Weighting In S&P 500)	**Q2'18E**	Q2'17A	**Q3'18E**	Q3'17A	**2018E**	2017A
Consumer Disc. (12.7%)	**10.10**	8.71	**10.44**	8.86	**40.16**	35.23
Consumer Staples (7.7%)	**7.60**	6.72	**8.17**	7.17	**30.82**	27.32
Energy (5.7%)	**6.50**	2.75	**6.82**	3.73	**25.26**	13.28
Financials (14.7%)	**8.49**	6.98	**8.70**	6.14	**34.45**	26.59
Health Care (13.7%)	**15.22**	11.78	**15.41**	11.37	**60.39**	45.08
Industrials (10.2%)	**9.47**	8.02	**9.62**	8.05	**35.87**	30.29
Information Tech. (24.9%)	**14.25**	10.81	**15.32**	12.20	**62.40**	50.59
Materials (2.9%)	**6.18**	4.89	**5.21**	4.10	**22.23**	17.18
Real Estate (2.8%)	**1.20**	1.29	**1.21**	1.56	**4.82**	5.60
Telecom. Services (1.9%)	**3.73**	2.80	**3.72**	2.74	**14.44**	10.18
Utilities (2.9%)	**3.35**	3.06	**4.93**	4.66	**15.74**	14.53
S&P 500 Index	**38.40**	30.51	**40.05**	31.33	**155.86**	124.52
S&P 400 Index (Mid-Cap)	**26.58**	19.79	**28.24**	18.23	**106.23**	78.12
S&P 600 Index (Small-Cap)	**12.53**	7.70	**13.26**	7.85	**50.34**	31.19

Source: Standard & Poor's (4/5/18). Sector weightings add up to 100.1% as of 3/29/18.

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