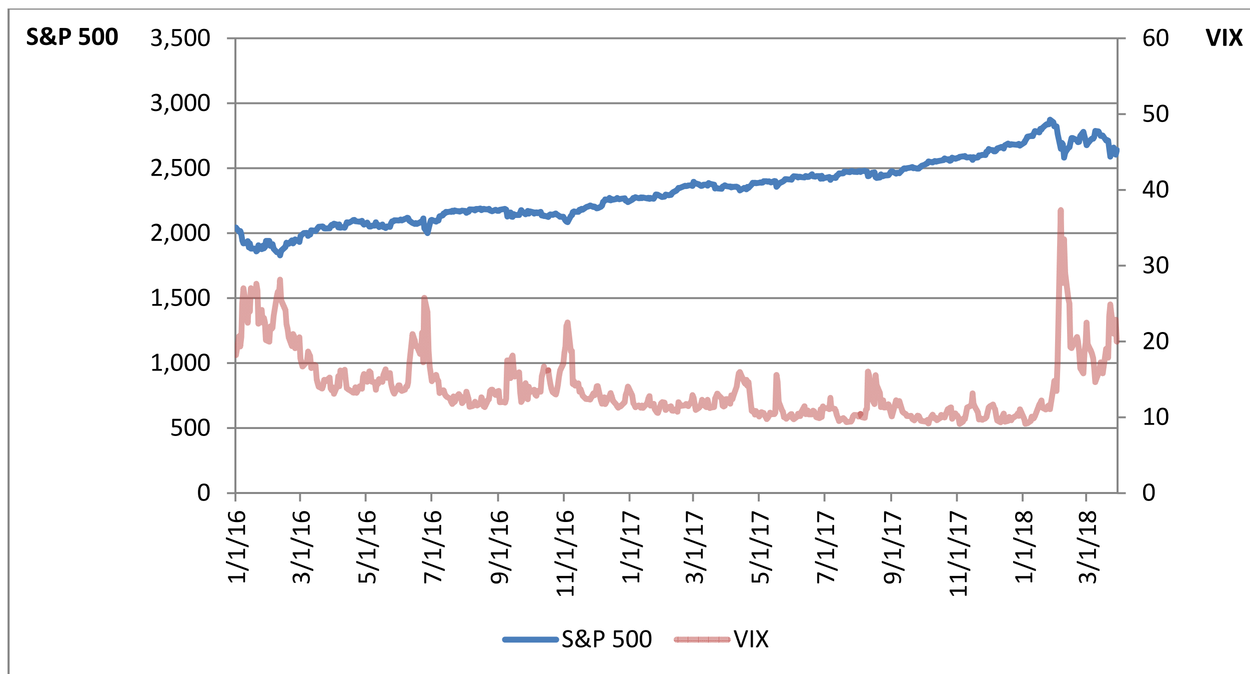
Q1 2018 – A Bunny Market?

In the financial world, market performance is generally described in animal terms – a bear market or a bull market. There are plenty of theories about how these terms came to be, but the only definitive answer is this: no one knows because the terms are centuries old. Let's take a look at some of the theories just for fun.

- Methods of Attack – When a bull attacks, it lowers its head and uses its horns to thrust its opponent up in the air. Hence, a bull market comes out of the market having been low, and then rapidly climbing. On the other hand, when a bear attacks, it swipes its massive paws down, bearing down on its opponent with full force. Therefore, it makes sense that a bear market is one that plummets.
- Bear and Bull Baiting – Another theory about the association of bears and bulls comes from the Elizabethan era blood sports "bear baiting" and "bull baiting." Arenas full of people would sit back and watch either a bull or bear be chained in the middle of a ring, and then attacked by a pack of dogs. This practice began as early as the late 1500s, and wasn't banned in England until 1835. Considering that the terms bull and bear markets originated around 1714, many believe that this is where the idea that bulls are the opposite of bears began.
- The London Stock Exchange – The London Stock Exchange was established at the turn of the 17th century, a time to which another explanation of the terms bear and bull market could potentially date back. At its inception, there was a bulletin board on which traders posted offers to buy different stocks. When there was a high demand for stocks, the board was full of bulletins, commonly called "bulls." When there was little demand, the board was "bare." Therefore, a bull market is when the market is up, and a bear (bare) market is when the market is down.
- Bearskin jobbers – In 18th century England the middlemen of bearskin sales were called bearskin jobbers, or bears for short. They would often sell the skins they didn't even have yet at speculative prices—and risk losses if the trappers decided to sell at higher-than-anticipated prices. The practice leant itself to a French proverb that translated to: "Don't sell the bear's skin before you've killed him." It's speculated that this is, perhaps, where the term bear market may have originated, because short sellers thrived in failing markets, thereby earning the title "bears' market."

So where are we now, you ask? *A Bunny Market*.   A bunny market describes a stock market that does not have an obvious direction but instead "hops" up and down but never strays too far from either direction.   Bunny markets are typically seen following an economic downturn (2008), when an economy is in the later stages of recovery (2018).

As the first quarter of 2018 closed, one theme in particular tops the mind of investors: the return of volatility. Stocks have behaved much differently as compared to the previous year. Over the course of the last 3 months, the S&P 500 experienced 6 trading days of +/- 2% moves. Since 1980, U.S. equities have averaged 15 such occurrences a year, although 2017 was abnormally calm, as there were zero days when the market moved more than +/- 2%. It is reasonable to expect significant daily moves to continue from time to time, as investors digest the effects of higher interest rates, inflation expectations, the impact of fiscal stimulus, and the trade tariffs.



The chart above illustrates what happens when volatility (VIX) remains low and the effects when there is a spike in volatility. As you can see, 2017 was the exception and 2018 is closer to the norm.

Sticking to a long-term plan is harder to do when markets don't just go straight up. But, ironically, it's probably a healthier investing environment. Valuations, which were quite extended as we entered 2018 have had a chance to retreat somewhat – courtesy of both the correction in prices, as well as strength in earnings. Traditional stock market fundamentals remain supportive of an ongoing market rise and the U.S. economy doesn't look to be near a recession, which has historically accompanied bear markets. The Index of Leading Economic Indicators (which includes initial unemployment claims) rose again in March hitting a 45-year low. According to Thomson Reuters, the estimated first quarter year-over-year growth of the S&P 500 may be the highest rate of growth in seven years. The U.S. economy should also have a tailwind that is just beginning due to the tax cuts that the majority of Americans are just now incorporating into their budgets.

What about overseas? Stock markets around the world have reacted negatively to what is, for now, a small risk of a trade war. If concerns were just trade related, it is likely that emerging markets stocks would be underperforming developed market stocks, given their heightened sensitivity to trade growth. However, since the market peak on January 26, 2018 the MSCI Emerging Markets Index has fared a little better than the basket of developed market companies. Secondly, global merger and acquisition deals increased making the month of March the third largest month ever for M&A deals, implying that business leader's outlook remains positive as earnings continue to increase.

Sharp moves in stocks, while unnerving at times, are part of being invested. It has been a while since the market has experienced volatility but underlying economic and corporate fundamentals continue to look favorable. Unfortunately, this bunny didn't bring with him any chocolate eggs.