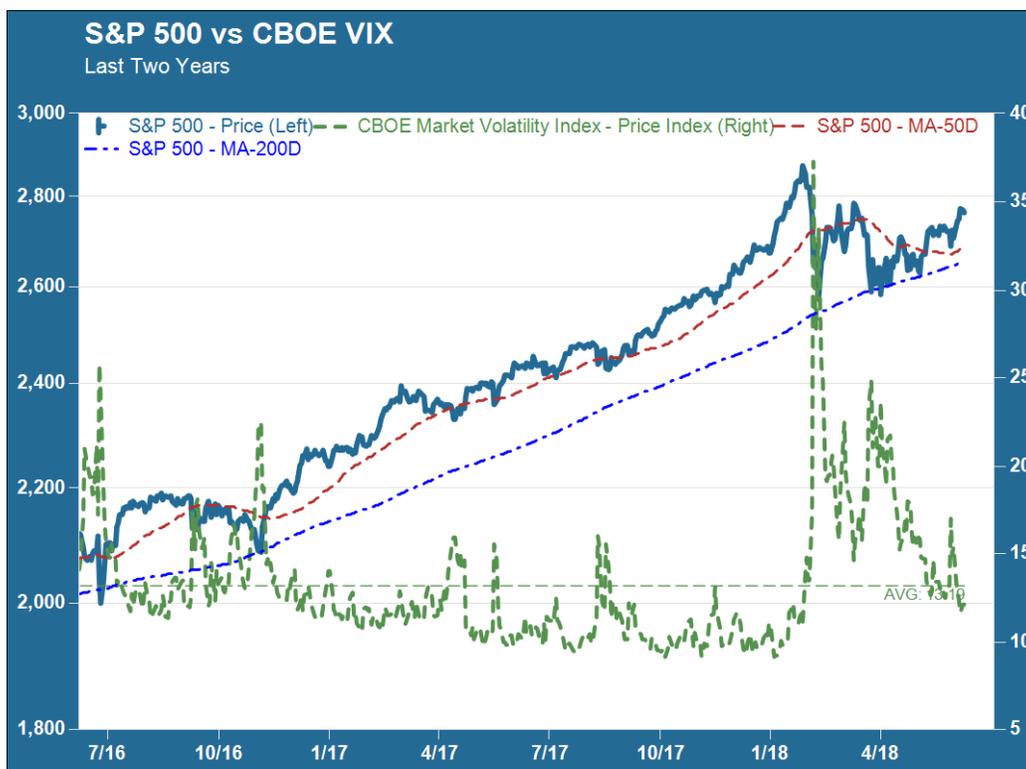


## Weekly Market Flash

### Volatility Heads for the Valley

June 8, 2018

At the beginning of this year we foresaw the potential for a spike in volatility. For awhile back in February and March that looked like a prescient call. Now...maybe not so much. As the predictable humidity settles into the Potomac region it would seem that the only high-octane energy around here is coming from DC's long-suffering sports fans, celebrating their hockey team's recent Stanley Cup victory (go Caps!). Risk asset markets, on the other hand, would appear...well, not as risky as they did a couple months back. The chart below shows the CBOE VIX index, a popular measure of market risk, alongside the S&P 500 over the past two years:



Source: MVF Research, FactSet

As we have noted in other commentaries the VIX, as a tradable entity itself, does not necessarily portray an accurate picture of market risk, particularly those Andean spikes that appear out of nowhere when algorithms hit their tripwires and summon forth the legions of trader-bots. But stock indexes appear becalmed as well when looking at internal volatility measures like standard deviation. We're not quite yet in the valley of last year's historically somnolent risk levels – but we seem headed that way and not too far off.

### Don't Grumble, Give a Whistle

Why the complacency? Even as we write this, the vaunted group of developed economies that call themselves the G-7 appear to be having a serious failure to communicate. Trade war rhetoric has stepped up following last week's imposition of steel and aluminum tariffs by the US on its supposed

allies including Canada and the EU. Italy, as noted in our commentary [last week](#), is grappling with a political crisis and potentially unstable financial situation. Geopolitics are on the front page with the US-North Korea summit in Singapore fast approaching, to say nothing of the uncertainty around the Iran nuclear deal, the North Atlantic Free Trade Agreement (NAFTA), and growing evidence of China seeking to extend its economic clout in Southeast Asia, Africa and Latin America. There are headlines aplenty (even ones that don't have to do with Trump's Twitter account or the musings of some or other comedian) that could keep investors fidgety – and yet they calmly whistle past the bad news on the way to the sunny climes of the volatility valley. The latest bout of buying has lifted the S&P 500 comfortably above the 50-day moving average resistance level, as the above chart shows.

### **Nothing Else Matters (For Now, Anyway)**

Actually, there is a reasonable justification for this midyear complacency, which is that for all the daily noise, not a whole lot has really changed in the macro picture. And what has changed – a little more inflation, a lot more growth in corporate sales and earnings – has largely been benign or downright positive. The tax cuts enacted at the end of last year may have a deleterious effect on the deficit, but such effect will likely not be felt for several years (“several years” being roughly equivalent to “an eternity” in Wall Street-speak). The trade war, should it come to pass, will also likely tend to have a gradual rather than an immediate effect, particularly on the domestic economy.

As for geopolitics – well, the market is extremely proficient in ignoring geopolitical concerns until they actually happen. That's not a recent phenomenon. British merchant banks were happily extending loans to their German clients in the summer of 1914, even after the assassination of Archduke Ferdinand in Sarajevo. The Great Trade War of 2018, so far anyway, is not conjuring up images of the Schlieffen Plan or entrenched battle lines along the Marne.

The S&P 500 is up about 3.5 percent (in simple price terms) for the year to date. Earnings per share for the companies that make up the index are projected to grow at around 20 percent for the full year, with top line sales coming in at a robust 7.5 percent. That's pretty agreeable math, and a decent reason to think that a fairly low-vol summer may be in store.

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