May 18, 2021

Putting Current Market Volatility into Perspective

Key Takeaways

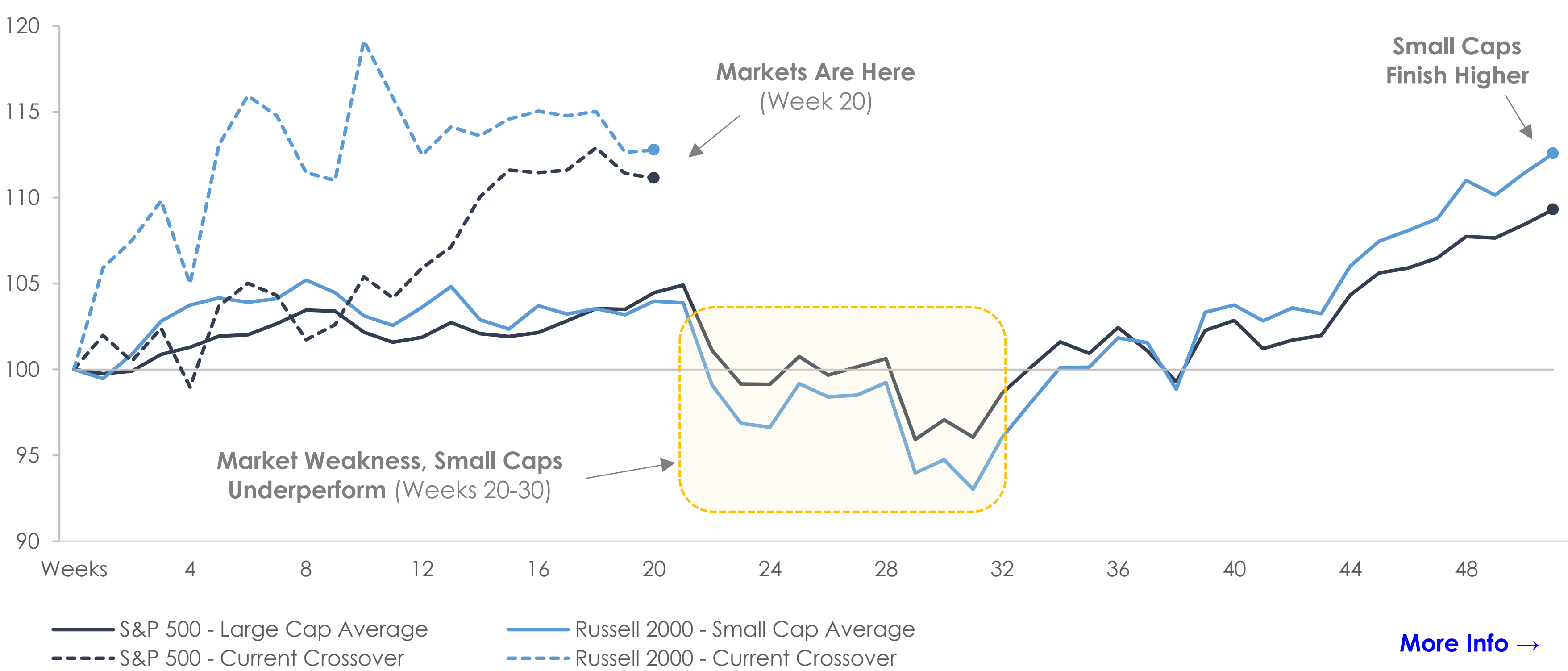
- History indicates the market is approaching a period of heightened volatility (i.e., vulnerable to shocks).
- The important item to note is markets historically resume their rally and trade higher following selloffs.

This QuickTake refreshes Figure 1 from the March 26, 2021 *Strategy Snapshot.* Figure 1 charts the average next 12-month return path for the S&P 500 and Russell 2000 the last three times the ISM Mfg PMI crossed above 59 and remained there for multiple months (Dec. 2003, Jan. 2011, & July 2017). Small caps produced a +12.5% average return over the next 12 months across the prior three instances, while large caps averaged +9.3%. Click the 'More Info' button to see the large and small cap return paths across each prior instance.

All three prior instances have a common trend -- markets encountered turbulence and sold off 20-30 weeks after the ISM Mfg PMI crossed above 59. The dashed lines in Figure 1 shows large and small caps both started to roll over and trade down slightly over the past month, which we attribute to elevated inflation readings and markets already pricing in a robust recovery and significant stimulus. Based on the recent Dec. 2020 crossover, the market reached week 20 last Friday, May 14th. This does not mean markets cannot deviate from history and reverse course to trade higher in coming weeks, because they can. The current environment is unique, and there is no modern precedent for the Covid-19 recession or large amount of fiscal stimulus proposed by the Biden administration. History simply indicates the market is vulnerable to unexpected shocks and now is the time to be mindful of risk.

The important item to note is large and small caps both historically resume their rally and trade higher after the week 20-30 selloffs. Small caps outperformed large caps following the Dec. 2003 (+8% relative) and July 2017 (+7% relative) crossovers but marginally underperformed after the Jan. 2011 (-3% relative) crossover. From a portfolio positioning perspective, longer-term oriented investors should view the volatility risk as a near-term speed bump, avoid making drastic portfolio changes, and consider buying the market dip. We continue to favor risk on assets, including cyclical sectors and factors, small caps, and high yield corporate debt. (Note: Refer to the May 2021 *Monthly Roundup* for our latest sector, factor, credit, and international ratings.) For tactical investors, history suggests now is the time to play defense by opportunistically booking reflationary gains and lowering portfolio beta. However, any significant portfolio moves should be viewed as short-term given the upside risk created by a strong bull market,

FIGURE 1 **U.S. Equities — NTM Return Path After Manufacturing PMI Crosses 59**



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