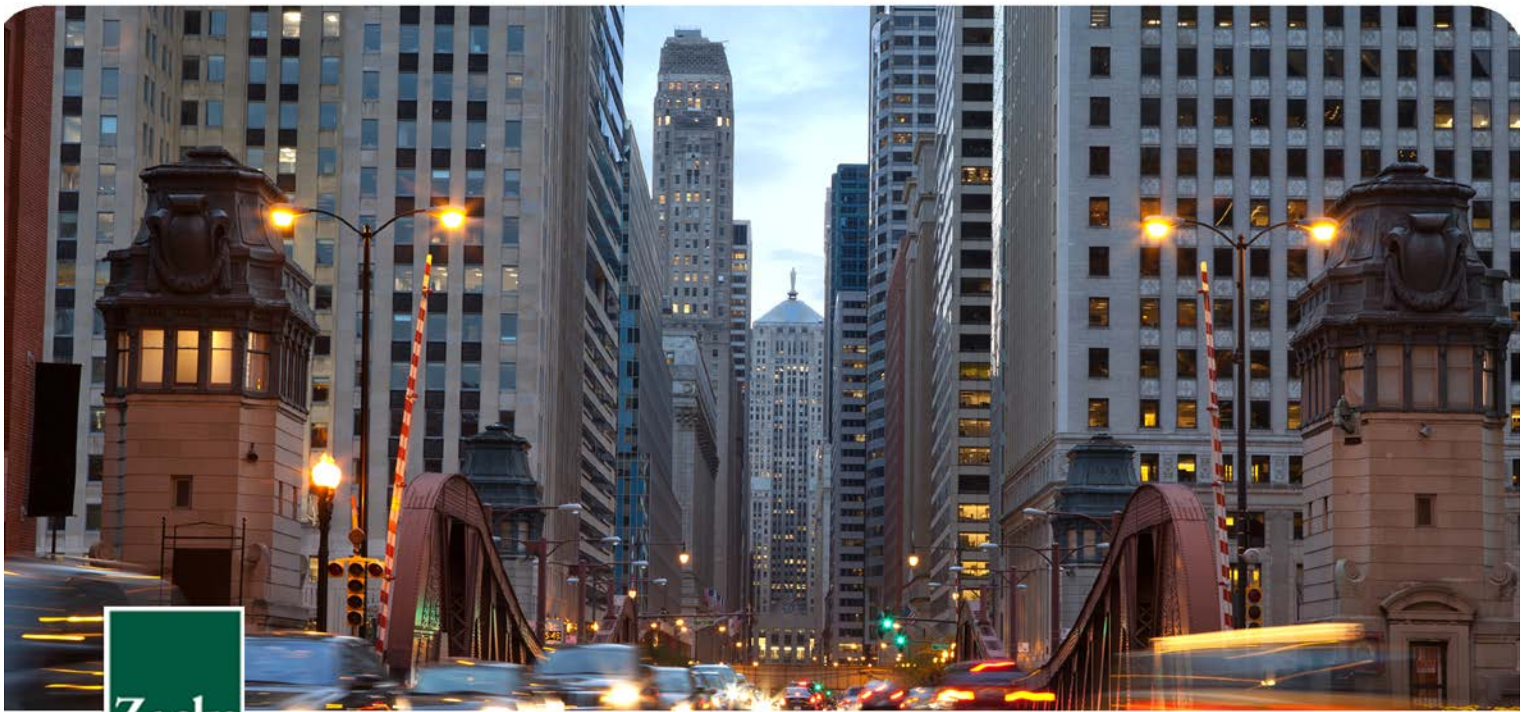


Market Insights by Mitch Zacks

Market Volatility – Like 2008 or 1998?

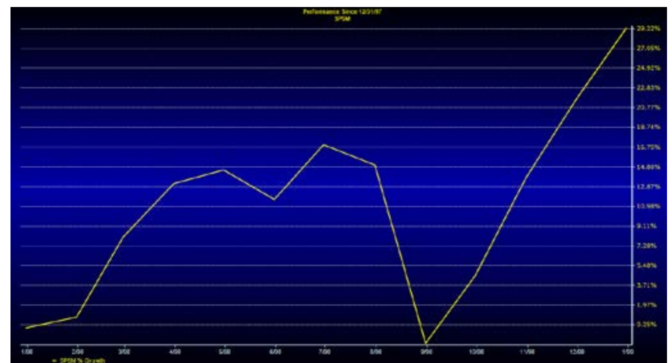
By Mitch Zacks
Senior Portfolio Manager

If you're nervous about where the market is headed (after enduring two eyebrow-raising weeks of pronounced volatility) then guess what - you're normal. Human nature is to fear losses, and memory of the 2008 bear market still lingers. Nobel Prize-winning psychologist Daniel Kahneman discovered that investors dislike losses roughly twice as much as they enjoy gains. Frankly, I think losses are despised even more than that.

It makes sense then that the current volatility has many questioning the sustainability of this bull market. The knee-jerk reaction is to sell stocks and ride-out volatility from the sidelines. But, I think that's the wrong move and I still see this current volatility as a short-term market correction, not a bear market. To me, this market is looking more and more like 1998 than 2008.

4 Reasons I Think This Market is More Like 1998 than 2008

Many investors won't remember this, but in 1998 the market took a steep dive from mid-July to mid-October, falling slightly more than 19% in total.



But in 1998, the market did what it classically does in a correction – it falls quickly and steeply, posts a mini-recovery mid-way through (kind of what we're seeing now), and then it falls quickly again until the correction finds its bottom. From there though, the market powers through to a very swift recovery, which in 1998 meant climbing some 28% from mid-October to the end of the year. Investors that got spooked out of the market given that volatility would have been majorly whip-sawed. My advice: don't be that investor.

Indeed, I see a similar pattern forming today. I wouldn't be surprised if the market continues bouncing higher after big down days, luring investors to believe the correction is over when in fact there is still more downside left. But that's ok! We're only about three weeks into this downside volatility, and corrections can last anywhere from a few weeks to a few months.

Investors should brace for continued volatility, but not fear it. I still think fundamentals point to more secular upside from here, and this downside volatility should be short-lived with a quick recovery in the wings – just like 1998.

Here are four similarities I see between 1998 and today:

1) Late Stage Bull Market – 1998 was the eighth year of a ten year long bull market, and 2015 marks the 6th year of our current bull market. A lot of folks think this is too long to be in a bull market, but that's a false thought – bull markets since the Great Depression have lasted an average of 8 or so years, meaning for this one to last two more years would be quite normal.

2) Concerns over Asian and Emerging Market Currencies – at present, many are worried that the strengthening dollar is going to doom Emerging Markets [EM], especially if you tack-on lost revenues due to falling commodities prices (since many EM countries are energy and mineral exporters). A strengthening dollar also hurts EM countries because their debt is almost universally denominated in dollars, meaning that a strong dollar equates to more costly interest payments. All very true. Interestingly though, the same scenario occurred in 1997, when global markets rattled over the Asian currency crisis. Countries like Thailand, Indonesia, and South Korea rapidly saw their currencies fizzle in value, and experts predicted a complete collapse in the global markets. But it didn't happen. The stock market corrected then and there was a carry-over into 1998, but it wasn't enough to send equities into a prolonged downturn. The China economy concern (and currency devaluation) of today shouldn't either.

3) Interest Rate Hikes Looming – as it turns out, 1998 was the precursor to a series of interest rate hikes by the Federal Reserve – just like 2015 seems to be. From 1999 – 2000, the Fed raised interest rates six times from 4.75% to 6.50%, but the market also annualized 5% over the same period! For everyone that fears interest rate hikes by the Fed, all they need is a history lesson: stocks have done remarkably well during the past three rate hike cycles.

4) Optimism Building, but Not Fully Developed – there's no quantitative evidence to support this, but my general feeling is that investors aren't entirely comfortable with this bull market. In my view, there has to be some level of unjustified optimism about stocks in order for me to believe they are overpriced. And I just don't see that today. In my opinion, stocks thrive on skepticism – they love to climb that 'wall of worry.' And that wall very much exists today, especially now.

Bottom Line for Investors

Many are tempted to think that this market's volatility is somehow unprecedented, and the media are quick to spin the downside. But that is simply the wrong way to think. The market has endured steep quick declines in the past (1998, 2011) and recovered briskly at a moment's notice. I think the same applies to the current scenario, and that investors should hold their breath a bit and remain patient. Downside volatility is scary, but often times it's just temporary. I think it is this time too.

-Best Regards,

Mitch

About Mitch Zacks

Mitch is a Senior 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.

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