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Chart of the week

What to make of the recent period of stock-market turmoil

Stock markets got beaten up in early October. The S&P 500 fell around 7% during the first two weeks of the month. Analysts were quick to point out that it is the worst start into the fourth quarter since 2008.

It's difficult to come up with convincing fundamental explanations for this poor performance: Granted, U.S. Treasury yields are up, now trading above 3% for the second time this year. However, as we have outlined recently (see Cotw 10/12/18), the increase in yields has primarily been driven by rising real yields. These tend to reflect rising growth expectations. In principal, faster real economic growth appears more likely to be a positive, rather than a negative factor for market sentiment. Of course, there are also plenty of political risks around, but most of them were around already before October. Maybe a combination of all these factors happening at the same time is to blame, notes Christoph Ohme, senior portfolio manager for German equities at DWS.

What's more, seasonality statistics tell us that October should actually be a good month for stocks. But there's another way of looking at seasonality: As our "Chart of the Week" shows, October is the most susceptible month to panic attacks, typically accompanied by unusually high levels of stock-market volatility. Taking daily data since 1980, average realized volatility tended to be fairly balanced for all calendar months. Only October stands out as the big exception. That's mainly due to the experience from two years, 1987 and 2008. No wonder that October is also considered the most likely candidate for crashes.

This suggests that when it comes to the latest weakness, it might indeed simply be another, temporary panic attack. That's something perfectly normal. From time to time, markets get nervous, before calming down again. It could as well be that markets have forgotten how to deal with volatility. After all, historically the S&P 500 has seen a 5% decline about every two months on average. We haven't had a single 5% decline in 2017. In 2018, the time lag between panic attacks has also been longer than usual. After all, far more than two months have passed since the last stock-market setback in February this year.

Potentially, the 7-months wait until the latest panic attack in October might actually be taken as a source of reassurance for superstitious bulls. For one thing, it suggests that at least until very recently, and at least as far as U.S. equity markets are concerned, investors were not all that worried about fundamentals. When it comes to October market nervousness, there aren't really any especially convincing theoretical explanations as to why to expect it. This stands in sharp contrast to other calendar effects examined in the academic literature and hints at an element of self-fulfilling.

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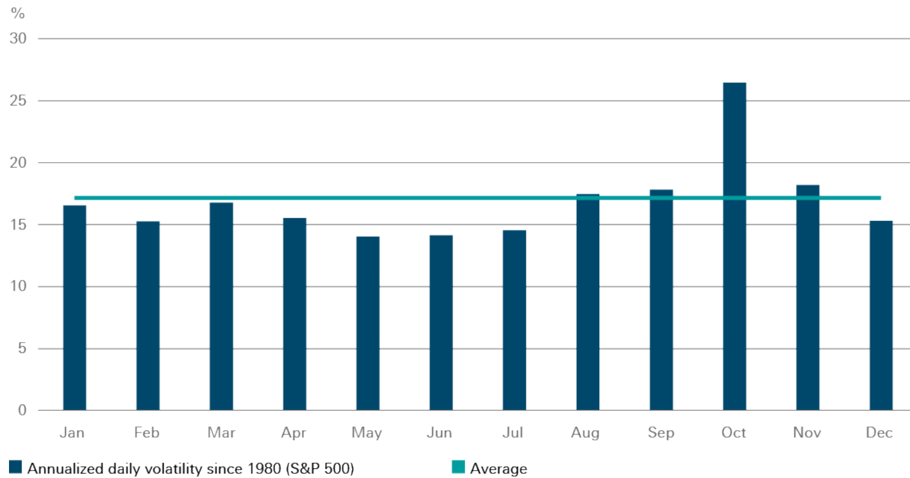
Perhaps, investors get nervous and vigilant in October, simply because they fear others might panic.



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 10/18/18

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Glossary

Fundamentals

Fundamentals are data giving information about the general well-being of companies, securities or currencies and serving for the subsequent valuation of these as an investment opportunity.

S&P 500

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Treasuries

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

Volatility

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

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