THE OMNIVEST MARKET VIEW
Investments

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# The VIX Index is Showing Signs of Stabilizing

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In the past seventeen business days, the VIX Index (volatility measure) has doubled from 24.3% to 48.2% before falling back to 34.57%. While the range has been substantial over this period, there does appear to be some semblance that volatility is beginning to settle into a much narrower range between 30% and 35%. This range has prevailed for the past eight trading days.

Even though the VIX Index is now trading in a narrow range, it is still elevated in comparison to the 15% to 20% range that prevailed in the March/April period of this year. The elevated range reminds us that complacency is a dangerous sentiment to maintain. Similarly, maintaining high levels of volatility sends a message that investors are too pessimistic on fundamentals and expected rates of returns.

Irrational exuberance appears to have given way to a new period of irrational pessimism. After all, the spectacular returns of 82% in the S&P 500 that were generated from the lows of March 2009 to the peak in mid-April 2010 were labeled as a bear market rally. This was further evidenced by the lack of money flows into equity mutual funds.

Last Friday, the regular set of bearish economists came out of their caves to growl about how the economy is beginning to slip back into an anemic pace of growth. They pointed to a much weaker than expected job creation report which showed that the private sector created only 37,000 jobs in May versus 156,000 jobs that were created in April.

Should we despair over the much weaker than expected jobs data in May? The correct answer is “no” and that one month of disappointment does not make a trend. What was barely discussed last Friday was the improvement in average weekly number of hours worked, which has now improved for the third consecutive month. Also, there was not much discussion around the fact that average hourly earnings rose by a healthy 0.3% and average weekly earnings also increased by 0.6% in May. The combination of higher average earnings, coupled with more hours worked, bodes well for retail sales in the months ahead.

Irrational pessimism is a state of mind that prevents investors from accepting good data, strong earnings or positive announcements. Instead, investors fret that the global economy simply cannot continue to grow at its current pace. Credit spreads are too narrow and the five week correction in the equity market is the beginning of another bear market. It is understandable why it is very difficult to be optimistic, given the explosion of debt that has been racked up by developed economies and the threat of downgrades that are likely to occur if these developed economies do not take quick action to reduce their bulging deficits. However, we should be clear that these concerns are for developed governments.

Corporations are in much better fiscal condition than the governments of the countries where they reside. So too, are the balance sheets of emerging market economies, in comparison to their more mature developed market trading partners. Pessimism may be warranted for developed government debt, but less so, for the private sector and emerging markets.



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