VAN LIEW TRUST COMPANY

as we see it

Winter 2018

THOUGHTS FROM OUR CHAIRMAN

In this issue of As We See It our associate Elizabeth Dellenbaugh discusses the timely topic of market volatility. Historically, equity securities that outperform during rising markets are often companies that are outpacing earnings expectations. In periods of extreme volatility all stocks are effected to varying degrees. While outperforming equity investments may exhibit volatility we recognize that within the context of a diversified portfolio their inclusion can help achieve desired results for the long term investor.

Alfred B. Van Liew

The Return of Equity Market Volatility?

Elizabeth Gordon Dellenbaugh

Seasoned investors know that when business reporters refer to "the VIX" they are not talking about a bunch of guys named Vic, but instead mean the Chicago Board Options Exchange (CBOE) Volatility Index®. Specifically, the VIX® is an index calculated and published by the CBOE which attempts to measure the stock market's expectation of volatility as implied by S&P 500 index options. It is one measure of market volatility. And volatility, of course, means a high likelihood of change, whether up or down. Statistical indicators come in and out of vogue with analysts and the VIX is trending right now. It is important, however, not to oversimplify the role of volatility in the equity markets. Volatility historically is normal. It is not necessarily "good" (leading to market increases) or "bad" (leading to market decreases). It is not necessarily an opportunity or a warning, though it may be either. As long term investors, we are attentive to volatility, including the VIX, just as we are attentive to other factors, but history shows it would not be prudent to let volatility alone distract us from our investment process and strategy.

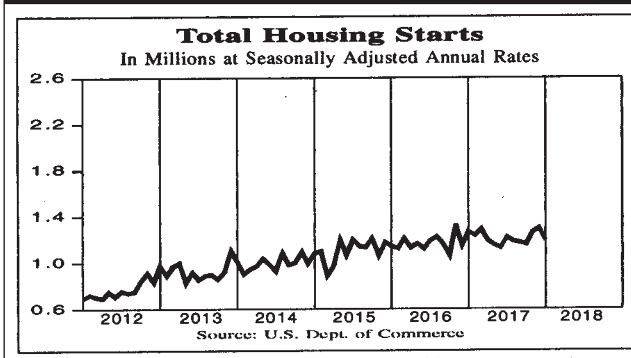
Some of the attention currently being paid to equity market volatility is because we haven't seen much for a while. In 2017 equity market volatility as measured by the VIX was, on average, lower than in any other year in the 25 years it has been measured. So when the equity market had a downward correction of 10.1% in February 2018 and volatility spiked upwards, investors noticed. But the sustained low volatility of 2017 was more the exception than the rule, and the return of some market volatility to date in 2018 seems more like a return to normal than, by itself, a cause for concern. As a recent analysis by Schwab's Randy Frederick shows, even when an increase in the VIX and a market decline do coincide, the effect historically has been short term. Most of the time, the S&P 500 has recovered over the following month. Two big exceptions to this were the bear market in August 1998 and the financial crisis in September 2008. Of course, past performance is no guarantee of future results.

What is behind the recent return of normal volatility to the equity markets? Different analysts point to different factors, but there seems to be greater diversity of opinion among investors as to where the markets are heading than when compared with last year. Some investors express concern over the length of the current bull market. Others point to expectations for higher interest rates or low unemployment. Still others focus on the stimulus of corporate tax cuts or international growth.

If more normal volatility sticks around in the equity markets, more opportunities may arise. Our long term investment process includes investing in stocks of companies we believe have strong growth potential that are fairly valued. When volatility is up, the prices of stocks move. This environment can create a buying opportunity when the stock price of a company is driven down. These buying opportunities are why long term investors can benefit from volatility. And while business reporters often refer to the VIX as "the fear index," we are mindful that one seller's fear is another buyer's opportunity. We adhere to the discipline of our investment process and seek to take advantage of such opportunities for our customers.

Research shows that in the one-year period following spikes in the VIX to over 30 (a medium high level), the S&P 500 had an average annual return of 7.9% (see Randy Frederick, Volatility Spikes: Warning or Opportunity? February 20, 2018). As long term investors, this correlation reminds us to stick to our investment process with a focus on asset allocation implemented with top-down and bottom-up analysis. We continue to focus on a full range of economic indicators. We believe the best investment results will accrue to those who do not simply fear the fear index.

T R E N D L I N E S



Housing starts struggled to show any growth in 2017, weighed by two hurricanes and cold weather late in the year. January 2018 housing starts were up 7.3% relative to January 2017. After a year hiatus, can spending on housing get back on track?

We would be delighted to meet with you to share comments about this article, or to review your portfolio in detail.

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Ask for Joe Healy or Ted Staples

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NEWPORT
Ask for Elizabeth Gordon Dellenbaugh