April 24, 2025

MARKET SIGHTLINES

Reflections on Equity Market Volatility

By Michael O'Keeffe, *Chief Investment Officer*

As we've discussed in previous editions, uncertainty has increased equity market volatility and triggered a deep market correction this year. Investors have been worried about tariffs and trade wars; inflation, Federal Reserve (Fed) policy, and presidential intervention at the Fed; and the increasing risks of recession. We maintain our view that things will end up more positive than people think, with improved trade deals, Fed independence, and a slowdown but no recession this year. In this week's Sight|Lines, we review the patterns of equity market volatility, reminding ourselves that this recent weakness may feel painful but is what we should expect from time to time as long-term equity investors.

THE TAKEAWAY: FEELINGS SKEW NEGATIVE, BUT MARKET WEAKNESS HAPPENS

Feelings about returns vary widely, so it helps to remember what to expect when it comes to market volatility. In summary:

- Investors often exhibit *loss aversion*, a bias where the pain of losing money feels more intense than the satisfaction of making gains.
- As of this writing, the S&P 500's current level represented a record back in June 2024, a time when investors likely felt pretty good about market levels.
- A review of market performance history shows declines happen within each calendar year.
- While a "market correction" usually alarms investors, they happen every 18 months, on average.
- The even more dreaded "bear market" has happened once every six years, on average.
- The S&P 500 has posted a return of -8.2% through April 23.
- To put this in context, our forward-looking Capital Market Assumptions would expect a return of -8% or worse to occur once every six years.
- A study of calendar-year returns going back to 2000 (Exhibit 1, page 3) reinforces these observations, illustrating that there are meaningful "peak to valley" negative returns every year, but the market earns a positive return in the majority of calendar years.
- Given that uncertainty around the Washington policy transitions will remain for some time, we should expect the elevated volatility to continue.
- That said, we expect worries about recession and market weakness to soften going forward.

IN-DEPTH: FEELINGS ABOUT RETURNS SKEW NEGATIVE DURING PERIODS OF WEAKNESS, BUT LONG-TERM EQUITY INVESTORS SHOULD EXPECT NEGATIVE RETURNS FROM TIME TO TIME

Feelings about returns can vary widely, so it is helpful to remind ourselves about what to expect when it comes to market volatility. Going deeper:

- *Loss aversion* is a bias where the pain of losses feels more intense than the gratification of gains:
  - Most investors experience loss aversion, and periods of market weakness can be emotional.
- As of this writing, the S&P 500's level represented a record back in June 2024:
  - When asked, most people would likely say they felt pretty good about market levels back then.
- A study of S&P 500 performance over 1954-2024 shows declines happened regularly:
  - A decline of 5% or more happened about twice per year, on average.
    - These lasted 46 days, on average.
  - A decline of 10% or more (a market correction) happened about every 18 months, on average.
    - These lasted 135 days, on average.
  - A decline of 15% or more happened about once every three years, on average.
    - These lasted 256 days, on average.
  - A decline of 20% or more (a bear market) happened about every six years, on average.
    - These lasted 402 days, on average.
- The S&P 500 has posted a return of -8.2% through April 23:
- Our forward-looking Capital Market Assumptions (CMA) are used for financial planning simulations:
  - Our CMAs estimate a return of -8% or worse will occur once every six years.
  - Our CMAs also infer a negative return once every three years.
- A study of calendar-year returns going back to 2000 (Exhibit 1, page 3) reinforces these observations:
  - Each year, investors experience meaningful "peak to valley" negative returns.
  - Notably, investors earned a positive return in 68% of these calendar years.
- The uncertainty around the Washington policy transitions will remain for some time:
  - We should expect market volatility to remain elevated during this period of uncertainty.
  - That said, we expect the uncertainty to slowly fade going forward:
    - We see an economic slowdown this year, but no recession.
    - We expect equity markets to move modestly higher, but with volatility.

CONCLUSION

Uncertainty has triggered a deep market correction this year. Investors remain worried about trade wars, inflation, Fed policy, and the increasing risks of recession. We believe the environment will get better, with improved trade deals, Fed independence, and an economic slowdown but no recession this year. So, as long-term equity investors, we are well served to remind ourselves that volatility and market weakness are a normal part of the investing experience.

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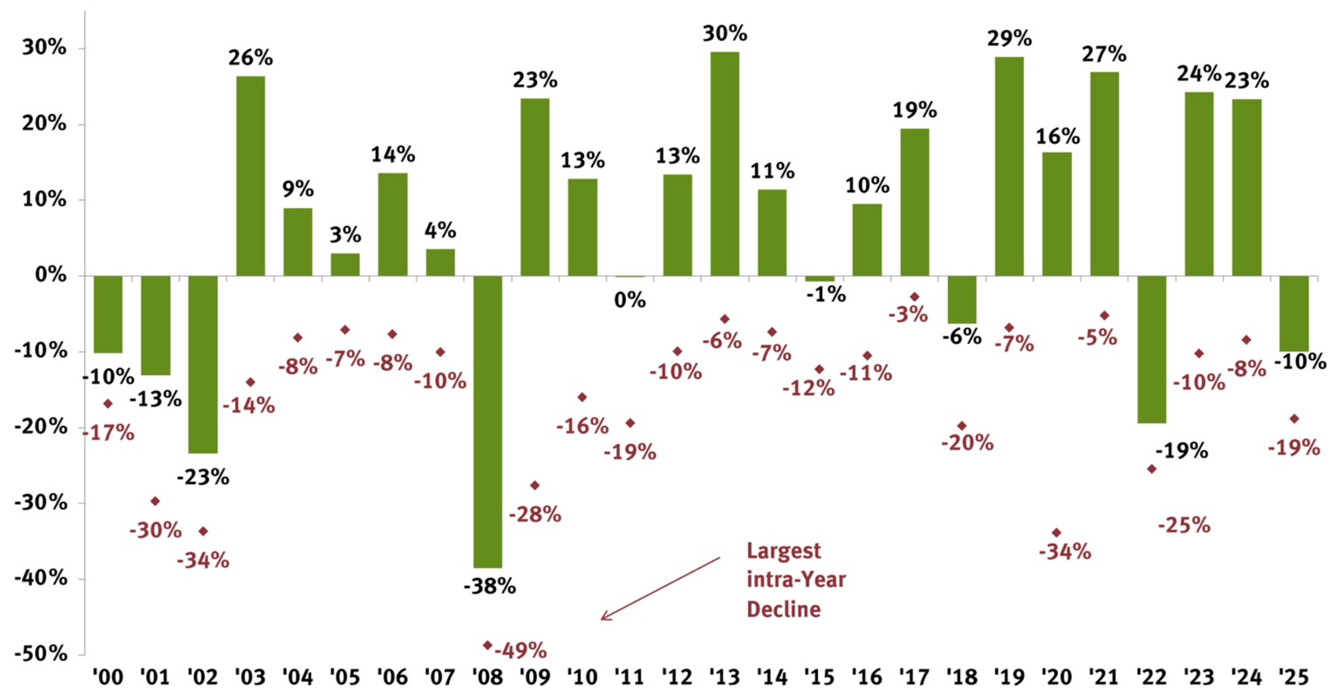
Exhibit 1



Source: Stifel Investment Strategy via Bloomberg, as of April 22, 2025