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Expect Higher Volatility

Last quarter, we received an increased number of calls of concern about the volatility of the markets when the S&P 500 dropped 5.8% from January 15th through February 3rd. Now that the dust has settled a bit, I thought that it would be a good time to discuss this subject.

First, I need to point out that we've become spoiled by a lack of volatility and more customary pullbacks in the stock market. The long-term average of the VIX, the most followed volatility index, is 21.8. Below, please find the movement of the VIX over the past year of trading. You can see that we are far below the historical norms. Our phone calls started coming in just as volatility was reaching the "normal" range.

I have also provided the S&P 500's price chart during the same time period. As you can see, the VIX typically begins to rise when the stock market is dropping in value. Investors begin to panic as a result of the market pulling back, often leading them to sell at exactly the wrong time. Feeding into this type of emotions based investing is a great way of being separated from your hard earned money.

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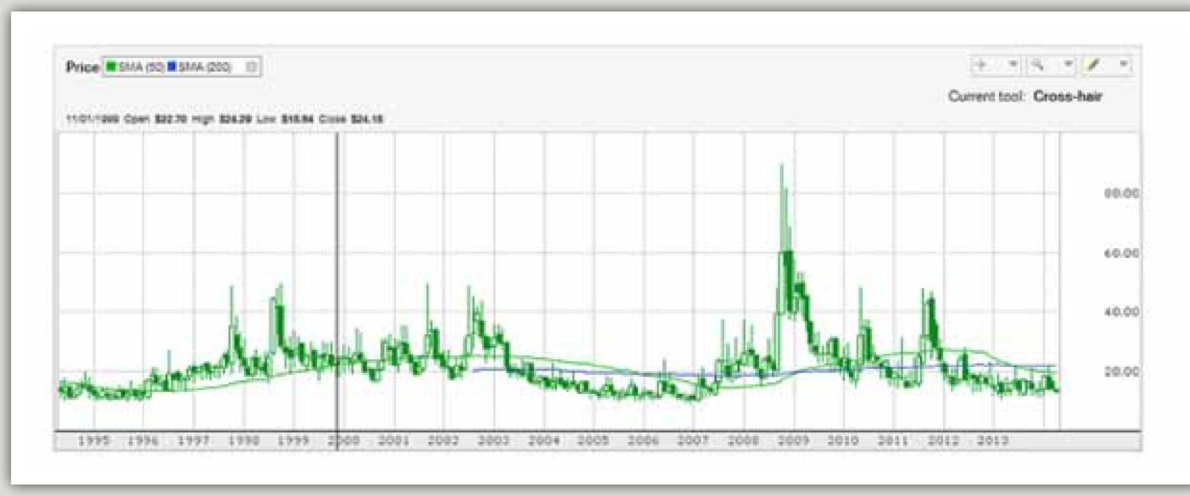
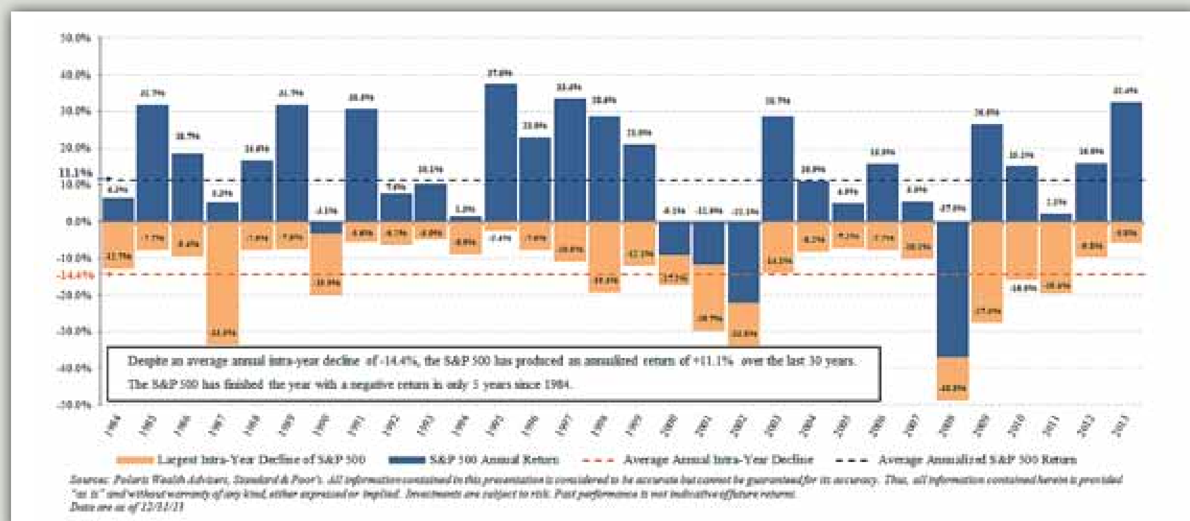
To give you a long-term perspective, I have also graphed the VIX monthly over the past 20 years. You can see that the VIX hit all-time highs in late 2008.



Prior to 2008, the VIX had spiked into the 50s a handful of times. The first was in 1997. The next time was during the Long-Term Capital bailout (tied to the Russian Ruble collapse) in 1998. The other times were after the September 11th terrorist attacks and in 2002 during the market's free fall. You may have also observed that we have been experiencing low volatility since mid-2012. The last such period of calm was from 2004 through 2007.

I also felt that it was important for you to understand the intra-year declines that the markets typically experience. Last year we experienced the smallest pullback in the market in almost 20 years.



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What you can see here from our study is that even though the markets have experienced an average annualized return of over 11%, the average intra-year decline was over 14%.

I think this is very important for the average investor to understand. We've had smooth sailing for several years. Be prepared to put on your seat belt because realistically, we will have more turbulence than you have grown accustomed to over the past few years. Increased volatility and normalized intra-year declines do not directly translate into negative or below average returns; it simply means that in most years, there will be a significant pullback during the course of the year. You can't allow these pullbacks to rattle you or change your resolve to invest in the stock market.

As always, I look forward to your comments and questions.

Sincerely,

Jeff