MARKETPLACE VOLATILITY: CALM BEFORE THE STORM
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"Danger always strikes when everything seems fine." From the movie "Seven Samurai" (Akira Kurosawa, director)

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CONCLUSION AND OVERVIEW

In World War One on the Western front, after the initial stages in the horrific conflict, for an extended period little net change occurred in the location of the front lines dividing the entrenched armies. For a long time, neither camp won a decisive breakthrough victory despite significant planning, extensive maneuvers, ferocious battles, great expense, and ongoing long-running carnage. The contending forces were at roughly equal strength.

In a given marketplace, the bulls and bears can be locked in vicious combat for an extended period (with bullish and bearish factors in approximate balance). This will tend to keep prices in a (relatively) quiet overall sideways trend for quite some time, even if some short term fluctuations seem striking. If bullish forces (even if powerful) have only slightly more strength than bearish ones, the upward trend will tend to be slow; the bear slide will be rather peaceful if bearish factors possess only a slight advantage.

Breakouts are not inevitable in either war (or politics) or financial marketplaces.

However, the current relatively (outwardly) calm price situation for the S+P 500, United States 10 year government note, and the broad real trade-weighted US dollar probably will not persist. Volatility likely will increase in these playgrounds in the fairly near future. The recent bloody fall in the petroleum marketplace is one warning flag portending this prospective volatility jump.

The political scene represents another danger signal. Politics of course often reflects and influences economic outcomes (and vice versa). The political arena can signal that "lots is going on under the surface" in the economic realm. The assorted and substantial divisions and fierce fights within the American political scene (as well as similar quarrels overseas) also hint that increased volatility looms on the marketplace horizon. Populist conflict with the establishment (elites) has not disappeared in either America or overseas. How strong is the quality of the American President's leadership, and how volatile is his temper, and how coherent and consistent are his policies? What if America and other key nations engage in passionate trade wars?

Current and forecast US federal budget deficits and burdens, already noteworthy, probably will explode if some form of President Trump's murky tax "reform plan" becomes law. But what happens to the joyous "Trump rally" in stocks if his tax scheme and massive infrastructure spending plans are not enacted? What if US corporate earnings hoards buried overseas are not persuaded via beneficial tax legislation to return home? What if US share buyback rates slow significantly? "US share buyback plan approvals plunge" (Financial Times website, 5/1/17). Although stock valuations can appear very elevated relative for an extended period of time, some marketplace captains nowadays proclaim that some measures show stock valuations are on the lofty side. Besides, legislative gridlock itself can spark changes in or accelerate existing economic trends.

The long run path for US government interest rate yields probably is upward, despite their recent near-term sideways motion. The Federal Reserve Board is gradually ending yield repression and boosting rates, and it may be willing to permit "overshooting" relative to its beloved two percent inflation target. The Fed murmurs about reducing the size of its balance sheet. Recent very lax monetary policy by the European Central Bank (including negative rates and money printing) has continued despite the Fed's slight policy tightening. What if the ECB cautions that it will become less accommodative? Also, watch GDP growth trends, inflation levels, and interest rates elsewhere; for example, note China's effort to rein in excesses in shadow banking and its property playground.

Judging from recent months, the US dollar's majestic bull trend seems to have halted. What happens to other marketplaces if the dollar begins a noteworthy retreat? Suppose foreigners become less willing to purchase, or become net sellers of, US Treasury securities?

Will conflicts involving North Korea, the Middle East, or elsewhere (note internal strife in Russia and Venezuela) escalate?

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From the long run historical vantage point, the VIX volatility index for the S+P 500 is very low nowadays. A sustained upward charge in this yardstick probably will help confirm the existence of a top in the S+P 500. In this context, watch US consumer confidence trends. Enthusiastic peaks in consumer confidence at times have occurred around the time as those in the S+P 500; consumer despair has occurred close to a bottom in the S+P 500.

VOLATILITY STORIES

In everyday casual marketplace speech, the word "volatile" applied to price swings reflects a subjective perception of relatively (and perhaps increasingly) violent price moves. In this context, the term usually refers to apparently unusual (abnormal; surprising, shocking) and generally rapid up and down swings. However, some audiences also apply the tag to seemingly remarkable and relatively fast price moves in a given overall direction.

Definitions and explanations of marketplace "volatility" and its implications for marketplace trends and risks vary according to the viewer's personal perspective. What counts as high (or too high), low (too low), or average (normal, reasonable, typical) volatility (and price movements) likewise is a matter of opinion. And so-called average volatility for a given financial domain or instruments within it can alter, sometimes dramatically.

In an effort to measure change, should one review a given marketplace over a fairly extended period of time? But how far back should detectives look? What about intraday volatility as opposed to longer run shifts? Some short-term players perceive big (significant) moves within a trading day, or from day to day, that longer term participants often will deem unimportant.

Besides, a trading battlefield such as the S+P 500 can manifest apparently towering climbs or savage drops within a given day, or over a few days, only to return back to the given starting point not long thereafter. Depending on the viewpoint, either quite a bit or not really very much happened.

Suppose a marketplace general looks at daily settlements (or daily ranges) as a starting point, whether for stocks, interest rates, currencies, or commodities. Should scouts measure volatility

moves arithmetically or in percentage terms? Of course the higher the price, the less significant in percentage terms becomes a given arithmetical price swing. For most longer term traders, a fifty point S+P 500 move in a given direction matters less with the S+P 500 at 2400 then it does when the index rests at 1400. Assume put and call options for a given marketplace trade actively. To what extent should guides rely on historic or implied options volatility in assessing "overall" volatility (and risks relating to) the given trading domain/

Within a given broad marketplace category such as stocks in general, volatility can vary. Some stock marketplaces are more volatile than others. Compare the S+P 500 to equity benchmarks for several emerging/developing nations. Or, over a given time horizon, a particular currency cross rate may fluctuate more violently than another. Within a given stock realm (such as the S+P 500) one or several stocks (or equity sectors) may appear substantially more volatile than others.

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Finally, picture various diverse marketplace battlegrounds, such as American stocks (S+P 500), United States government interest rates (10 year Treasury note), the US dollar (broad real trade-weighted), and the petroleum complex (or commodities in general; see the broad Goldman Sachs Commodity Index). Volatility within these various territories is not necessarily the same.

The extent to which important economic variables and realms (including financial marketplaces) overlap and their alleged trends converge or diverge (lead or lag each other) are matters of opinion, as are perspectives on and reasons for such relationships and movements. Marketplace history need not repeat itself, either entirely or even partly. Therefore these relationships can change, sometimes dramatically.

In any case, history reveals that trends for and levels in these (and other related) marketplaces intertwine, and often quite closely. Therefore the "overall" volatility pattern across these fields (despite individual measured volatility differences between them) at times can seem to some interpreters as "roughly the same". Thus (whether from the price perspective alone or in conjunction with fundamental variables) these assorted marketplaces can appear as "wild all at the same time", or "relatively peaceful together".

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In the famed movie depicting World War One, "All Quiet on the Western Front" (Lewis Milestone, director), a soldier declares: "We live in the trenches out there, we fight, we try not to be killed; and sometimes we are. That's all."

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The US 10 year Treasury note has sauntered sideways in a narrow 50 basis point range since 12/15/16's 2.64 percent top (3/14/17's 2.63pc). The low is 4/18/17's 2.16pc. Key resistance for the UST 10 year note is around 2.65 percent. Half the 6/13/07 major yield peak at 5.32 percent is 2.66 percent. Twice the 7/6/16 major bottom is 2.64pc. Recall the 2014 drop-off heights at 2.69pc (7/3/14)/2.65pc (9/19/14) which followed 1/2/14's 3.05pc peak.

The broad real trade-weighted dollar ("TWD"; Federal Reserve Board, H.10; monthly average, March 1973=100) likewise has been relatively peaceful in recent months. The broad real TWD attained a new high in its long bull campaign (which began in July 2011 at 80.3) on December 2016/January 2017 around 102.8. It has quietly meandered lower, but only modestly, since then. April 2017's dip to 99.8 in April 2017 is a paltry 2.9 percent decline.

The nominal broad TWD has daily data. It stood at 122.8 on US Election Day (11/8/16). After Trump's victory, it raced up to 11/23/16's 127.9, thus piercing 1/20/16's 126.0 resistance. Its highs in its bull move are 129.1 on 12/28/16 and nearly 129.0 on 1/3/17. The ensuing low since then is 3/28/17's 123.8 (data available through 4/28/17; 4/18/17 about 123.8 as well). This falls about 4.1 percent from December 2016's peak.

The mighty S+P 500 continued its major bull trend by climbing in the aftermath of the US national election, with the New Year's 7.5 percent jump from 12/30/16's 2234 to 3/1/17's 2401 height a noteworthy stage. But since the early March high, the S+P 500 leisurely strolled in a narrow track, with 3/27/17's 2322 a modest 3.3pc slide from there. And levels for the widely-watched VIX/S+P 500 volatility index generally have edged lower. Though the VIX rallied from about 11.0 on 8/9/16 to 23.0 on 11/4/16, it slumped to 9.97 on 2/1/17; its 16.3 high on 4/17/17 did not match the November 2016 plateau, and the lower volatility trend resumed thereafter, reaching 9.90 on 2/1/17. Notably, 5/1/17's 9.90 is the lowest VIX level since the 9.39 (12/15/06)/9.70 (2/14/07) depths achieved during the glorious Goldilocks Era (preceding the 2007-08 global economic disaster).

Thus the UST 10 year, broad real trade-weighted dollar, and the S+P 500 all look rather quiet nowadays (not very volatile).

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Use the broad S&P Goldman Sachs Commodity Index ("GSCI") as a benchmark for commodities "in general". Commodities in general and the petroleum complex in particular of course have their own supply/demand situations and enthralling stories. Yet they are not entirely independent of financial theaters such as the S+P 500 (and emerging marketplace stocks), key government interest rates, and major currencies such as the dollar. Recent years evidence rather close connections between price trends in the GSCI and petroleum and those in stocks, the UST, and the TWD.

NYMEX crude oil (nearest futures continuation) traded sideways from around 1/3/17's top at $55.24 to 2/23/17's $54.94 ($50.71 low 1/10/17). Then tranquility ended. The price fell sharply, 14.4 percent, to $47.01 on 3/22/17. It advanced quickly (in three weeks, also 14.4pc) to 4/12/17's $53.76. Yet crude oil thereafter cratered 18.6 pc, reaching $43.76 on 5/5/17 (a 20.8 pc tumble from 1/3/17). The broad GSCI's high in its bull move was 409 on 2/13/17, with a second summit at 403 on 4/12/17. It collapsed to 361 on 5/5/17, down 10.4pc from its February 2017 height.

Thus the recent rapid (violent) collapse in commodities hints that the relatively peaceful current trends in the S+P 500, US 10 year government note, and the broad real trade-weighted US dollar likely will not persist.

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Suppose yields of US interest rate signposts such as the 10 year government note continue their long run rising pattern (which began 7/6/16 at 1.32 percent). What will it mean for marketplace volatility and trends outside the interest rate arena if the UST's yield eventually vaults over 2.65pc and assaults the important 3.05pc resistance?

In the glorious Goldilocks Era, a sustained upward march in US government interest rate yields helped lead to (occurred before) the pinnacle in the S+P 500. The UST 10 year yield peaked at 5.32 percent on 6/13/07, the S+P 500 on 10/11/07 at 1576. In the current landscape, higher interest rates probably will diminish corporate profitability and boost US federal deficit burdens.

In any case, rising rates at some point (thus "leading the way') eventually can link with US (and emerging marketplace) stock marketplace tops. In this context, players should monitor whether declines in the S+P 500 and emerging marketplace stocks (MSCI Emerging Stock Markets Index, from Morgan Stanley; "MXEF") connect with (confirm) slumps in the petroleum complex and the broad GSCI. Trends in emerging stock marketplaces in recent years have paralleled those in commodities in general (particularly petroleum and base metals). Suppose the broad real trade-weighted dollar is "too strong" in the global stock marketplace context. The TWD probably became so around the time of December 2016's 102.8 level and thereafter, for it sustained levels above January 2016's 100.9 interim top.

VOLATILITY, CONFIDENCE, AND THE S+P 500

In "The Rocky Horror Picture Show" (Jim Sharman, director), The Criminologist states: "I would like, if I may, to take you on a strange journey."

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Significant volatility shifts for a given marketplace, particularly from historically "low" or "high" levels sometimes can warn of or roughly coincide with important trend changes in that marketplace. The VIX volatility index for the S+P 500 stock index is an example of this. According to the CBOE's website, its "Volatility Index® (VIX® Index is a leading measure of market expectations of near-term volatility conveyed by S&P 500 Index (SPX) option prices."

Timing linkages between the S+P 500 and VIX volatility levels are not always precise so observers should be cautious in evaluating the relationship and its implications. And marketplace history is not marketplace destiny.

The VIX often spikes to a key summit around a period when the S+P 500 (and perhaps related stock marketplaces as well) establishes an important bottom.

For the later stages of the Goldilocks Era to the present (the past decade or so), the VIX tends to make a noteworthy low (usually around 16.0 or less) either as a prelude to or around the time of an important price high in the S+P 500.

However, this guideline is not an absolute decree. The S+P 500's 3/6/09 major bottom was not associated with a low VIX level, but with a still-lofty one. The VIX thereafter declined as the crisis became less severe and so-called normalcy began to reappear.

Alterations in the VIX level can be very fast, often reflecting heightened marketplace excitement (agitation).

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What happened to VIX volatility during the latter part of the Goldilocks Era and the subsequent crisis? Several months before the advent of the global economic crisis, the VIX established a major bottom at 9.39 on 12/15/06. After making a second important low at 9.70 on 2/14/07, and following a final key low on 6/20/17 at 12.75, it thereafter ventured and stayed above 13.0. This gradual rise in the VIX was an important omen for the S+P 500.

The S+P 500's initial peak was 7/16/07's 1556 (VIX low that day at 15.3); price fell to 1371 on 8/16/07 (VIX high that day 37.5), with the major summit 10/11/07's 1577 (VIX low 16.1). The

S+P 500 sagged to 1270 on 1/23/08; the VIX high that day was 37.6. A noteworthy interim pinnacle occurred 5/19/08 at 1440; the VIX had faded to a low of 15.8 that day.

Although the VIX lows on 7/16/07 (15.3), 10/11/07 (16.1), and 5/19/08 (15.8) were higher than the almost ground floor levels (under 10.0) of December 2006/February 2007, they were (are) still fairly low by historical standards. The July 2007, October 2007, and May 2008 VIX lows also are low compared to the VIX's interim highs (alongside S+P 500 interim lows) around them (8/16/07's 37.5; 1/23/08's 37.6), and very distant from VIX highs achieved later in the dreadful S+P 500 crash.

The VIX exploded as the S+P 500 and other stock marketplaces around the world collapsed, reaching its 89.5 zenith on 10/24/08. Although the S+P 500 did not bottom around that day, the MXEF emerging marketplace stock index did, at 446 on 10/28/08. However, at the time of the S+P 500's 3/6/09 major bottom at 667, the VIX nevertheless was very elevated from the long run historical perspective that day, touching 52.0 (after running up from 1/2/09's 36.9). As the S+P 500 rallied, the VIX retreated from its still relatively historically high absolute level.

What about some later points suggesting guideline relationships between the VIX and S+P 500?

4/12/10 VIX bottom at 15.2; 4/26/10 S+P 500 top at 1220
5/21/10 VIX top 48.2; 7/1/10 S+P 500 low at 1011 fairly close in time to this.

4/28/11 VIX bottom 14.3; 5/2/11 S+P 500 plateau at 1371
8/8/11 VIX peak 48.0, 10/4/11 VIX summit 46.9; key S+P 500 bottom 10/4/11 at 1075

3/6/12 VIX low 13.7; 4/2/12 S+P 500 interim crest at 1422
6/4/12 VIX summit 27.7; 6/4/12 S+P 500 bottom at 1267.

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After the June 2012 VIX and S+P 500 conjunction, their relationship seemed to change to some extent for the next two years plus a few months. This span showed generally sustained relatively low VIX volatility linked up with (reflected by) the ongoing S+P 500 major bull trend (high and even higher prices). This VIX/S+P 500 pattern during this time span coincided with arguably even greater overall global central bank monetary stimulus (accommodation). The very lax monetary policies likely reduced bearish fears regarding US stocks (and thus helped to reduce/minimize bearish S+P 500 moves).

In any event, noteworthy lows and highs for the VIX during the period after June 2012 include:

3/4/13 VIX low 11.1; 6/24/13 VIX high 21.9.

7/3/14 VIX low 10.3; 10/15/14 VIX top 31.1. The Federal Reserve ended its quantitative easing program in October 2014. The VIX slumped to 11.5 on 12/5/14, but flew up to 25.2 on 12/16/14 before falling.

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Since around mid-year 2015, it appears that the 2010-2012 relationship between important VIX and S+P 500 tops and bottoms has resurfaced. VIX volatility lows associate with peaks in the S+P 500 price; VIX bottoms seem allied with tops in the S+P 500 price.

8/5/15 VIX low 10.9. Although the S+P 500's very important interim peak occurred before this, on 5/20/15 at 2135, subsequent S+P 500 tops that summer bordered the May 2015 one and occurred close in time to the August 2015 VIX bottom. See the 7/20/15 high at 2133 and the 8/18/15 one at 2104.

8/24/15 VIX pinnacle 53.3 (settlement 40.7); S+P 500 low 1867. The VIX closed at 19.1 on 8/20/15, rising sharply to close at 28.0 on 8/21/15 before its volcanic eruption to 8/24/15's 53.3.

10/28/15 VIX low 12.8; S+P 500 interim high 2116.
1/20/16 VIX top 32.1; initial S+P 500 low 1/20/16 at 1812, final bottom 2/11/16 at 1810.

The VIX made a lower high with 6/27/16's 26.7; recall the S+P 500's low at 1992 that day. After making a low at 11.0 on 8/9/16 (S+P 500 minor high 2194 on 8/25/16), the VIX climbed to 23.0 on 11/4/16, shortly before the US election. The S+P 500 made a low around 2084 on 11/4/16. The VIX slipped to slightly beneath 10.0 on 2/1/17, about a month before 3/1/17's 2401.

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Although the VIX hopped up to 16.3 on 4/17/17, it fell to 9.90 on 5/1/17. This is not only less than the lows achieved since spring 2010, but also is the lowest since the winter 2006-07 eve of the global financial crisis (troughs at 9.39 on 12/15/06 and 9.70 on 2/14/07). The VIX of course may stay low or move lower as time passes, and the S+P 500 could mount higher. A one pc move in the S+P 500 over its March high is 2425, a five pc one gives 2521.

However, the current very low VIX level coupled with the rather heavenly S+P 500 height warns that a shift (increase) in VIX volatility could link to (confirm) an important top in the S+P 500. Thus marketplace warriors should watch to see if the VIX level climbs decisively from around current levels.

As a footnote, focus on timing issues. The S+P 500's monumental rally from its 3/6/09 major bottom at 667 is about an eight year diagonal bull move. The S+P 500 probably has traveled far enough in distance and long enough in time terms to be on the lookout for a trend change. For the near term, recall that several important S+P 500 highs in recent years were attained around calendar May. Recall 5/2/11's S+P 500 plateau at 1371. Also, an important interim top in the S+P 500 during the global financial crisis occurred in calendar May, on 5/19/08 at 1440. The critical pinnacle of two years ago at 2135 occurred 5/20/15. The 4/26/10 S+P 500 top at 1220 was not distant from calendar May.

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Are we (or at least many of us) in a new Goldilocks Era nowadays? Overall American household net worth has skyrocketed since the dreadful depths of the global economic debacle. US unemployment has plummeted. But is the S+P 500 nowadays irrationally exuberant or close to being so? Are President Trump and his comrades, emboldened by their arsenal of plans and rhetoric, really going to "Make America Great Again!"? In any case, very low VIX volatility should warn stock (and other) marketplace profit-hunters to guard against complacency; sentinels should beware of notable trend shifts in stocks (and elsewhere).

In an assessment of current and potential trends for the S+P 500 (and other equity marketplaces) and VIX volatility (as well as for trends for the UST 10 year note, broad real trade-weighted US dollar, commodities in general, and real estate), pay attention to American consumer confidence measures. After all, consumers represent the major share of US real GDP.

Admittedly, US consumer confidence is very high. But this sunny horizon existed around times of other S+P 500 peaks in recent years. And weak consumer confidence has occurred around US equity marketplace bottoms.

The Conference Board reports that US consumer confidence, in its determined climb from February 2009's 25.3 abyss during the terrifying global economic bloodbath, attained a new high in March 2017 at 124.9 (1985=100). Consumer confidence was 92.6 in November 2015, 103.5 in September 2016 (110.8 in October 2016). It then ascended further, as did the S+P 500, after Trump's triumph.

March 2017's magnificent consumer confidence height, though it is not an all-time record, surpasses the wonderful Goldilocks Era peak, July 2007's 111.9 (10/11/07 S+P 500 pinnacle at 1576). March 2017's elevation stands within shouting distance of the January/May 2000 summits at 144.7 (S+P 500 plateau was 3/24/00 at 1553).

However, consumer confidence fell in April 2017 to 120.3. Further dives in this measure would be an ominous bearish sign for the S+P 500, particularly if they occurred alongside a climb from current low levels in the VIX volatility index.

In the US confidence context, also monitor confidence measures related to the small business field. For example, see the small business "optimism index" (National Federation of Independent Business, "Small Business Economic Trends", March 2017; released on second Tuesday of each month). This optimism index, at least since the depths of the financial crisis, shows a rough similarity to patterns in the Conference Board's Consumer Confidence index and the S+P 500. The NFIB index made a bottom at 81.0 in March 2009 (1986=100). It gradually climbed, but with assorted ups and downs on the way. It reached 100.3 in December 2014, but remained under this until recently. In October 2016, just before the US election, it was 94.9. However, it soared to 105.9 in January 2017, edging down to 104.7 in March 2017. Suppose US consumer confidence slumps. Will this index decline too?

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Recall the US "housing crisis" that erupted during the Goldilocks Era in 2007. Has "high volatility" been abolished in real estate? "Boom puts US real estate in a risky location" and "Watchdogs nervous about bank exposure to frothy market" notes the Financial Times (4/13/17, p13).

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The long-running marketplace manipulation (using weapons such as yield repression and money printing/quantitative easing; also their forward guidance bulletins) by the Federal Reserve Bank, European Central Bank, Bank of Japan, Bank of England, and China probably has generated a significant amount of complacency in many marketplaces. Increased volatility (especially if sustained), whether in US stocks alone or also in other key marketplace realms (including interest rates, currencies, and commodities) eventually may reduce the widespread faith that the armada of central banks can engineer generally "good" economic outcomes (or at least can minimize the likelihood or consequences of bad ones).

The Federal Reserve meets 6/13-14/17, 7/25-26/17, and 9/19-20/17.

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For further marketplace analysis, see essays such as " The Oil Battlefield: Evolution, Relationships, and Prices" (4/10/17); "Eurozone Under Siege: Currency Trends and Policies"

(3/20/17); “Easing Comes, Easing Goes: US Government Interest Rates” (3/13/17); “Rhetoric and Global Currency Trends” (2/13/16); “Gold and Goldilocks: 2017 Marketplaces” (1/10/17); “Back to the Future: the Marketplace Time Machine” (12/13/16); “The New World?! US Election Aftermath” (11/15/16); “US Election 2016: Rolling and Tumbling” (11/6/16); “Running for Cover: Foreign Official Holdings of US Treasury Securities” (10/13/16).

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