Why the Next Market Crash Could Be a Doozy

Description

Vanguard founder Jack Bogle has been around the investment game for decades, and while you'd think at this point in his career that he's seen everything, you'd be wrong. In a recent interview conducted by CNBC, Bogle implied that there's something different about the volatility this time around.

"I have never seen a market this volatile to this extent in my career. Now that's only 66 years, so I shouldn't make too much about it, but you're right: I've seen two 50-percent declines, I've seen a 25-percent decline in one day and I've never seen anything like this before," said Bogle in a CNBC interview.

Coming from such an influential man in the investing world, the comments on volatility surges are alarming, but it's not necessarily a sign that something's horribly dysfunctional with the markets. After a parabolic surge to start the year, it's only healthy to see a reversion back to the mean regardless of what investor sentiment is.

Is this escalated volatility a symptom of an imminent market implosion?

The sudden 360-degree flip in market sentiment and surge in volatility is unheard of to many investors, but it's not a warning sign of an imminent market crash. However, given the recent bouts of volatility, it may seem like such to some.

So, why the volatility surge? And why is it different this time around?

The popularity of passive investment instruments like ETFs and index funds seems to have paved the way for higher levels of volatility moving forward. Speculators can buy and sell broader baskets of stocks at a whim these days, and as a result, market-wide changes in sentiment can move the broader market by a greater degree of magnitude. Thus, upward and downward moves may be amplified such that +1% market moves may be the new +0.5%. And +4% moves may be the new 2% and so on.

As such, in times where the general public is greedy, we may witness more parabolic “melt-ups,” and when they’re in a panic, well, we could see very sharp crashes resulting in a greater magnitude of declines relative to the past.

Nobody knows when the next crash will be, but when it does happen, stock investors are going to need a higher risk tolerance to cope with steeper losses than those experienced in the past. Moreover, when times are good, investors will need to control their greed, as rallies may be sharper and experience more corrections than we’ve witnessed before.

Bottom line

The recent market moves may be horrifying to some, but I think the escalated volatility caused by passive investment instruments will create a more favourable environment for stock pickers (versus passive investors), as larger magnitudes of stock market movements will produce exaggerated downward movements in the stocks of individual businesses that may not be troubled at all.

As such, I believe the rapid rise of passive investment instruments has made the stock market considerably more inefficient due to such exaggerated broader market movements. Thus, I believe the efficient market hypothesis may be going out the window as stock prices become less accurate determinants of the true intrinsic value of a particular stock.

If a higher volatility environment bothers you, it may be time to create an all-weather portfolio with low-beta stocks like **Fortis Inc.** (TSX:FTS)(NYSE:FTS) so that you can adapt to your personal appetite for volatility.

Stay hungry. Stay Foolish.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. TSX:FTS (Fortis Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/08/25
Date Created

2018/04/16

Author

joefrenette