
IS THE CORRECTION OVER?

Luciano Siracusano — Chief Investment Strategist

10/27/2015

Back on July 20, with U.S. stock indexes not far from their yearly highs, I said on CNBC that I expected the market to become choppy over the next three months. I pointed out that with the [S&P 500 Index](#) trading at nearly 19 times—and corporate earnings unlikely to advance in the second half of the year—the market would need to digest not just the slowdown in China but also the uncertainty that would accompany a pending [Federal Reserve \(Fed\) rate hike](#), scheduled European elections and our own budget process and [debt limit](#) debate come this fall. Over the five days following July 20, the S&P 500 declined 3%. In a follow-up blog post, I elaborated on [why I thought the August-to-October time frame was the most likely period for the U.S. stock market to correct](#). When the 1,000-point sell-off in the [Dow](#) arrived a month later on August 24, not only had the correction cleared out excess investor exuberance, it showcased a selling frenzy that rivaled Wall Street's worst days over the last two decades. The [Volatility Index \(VIX\)](#), which measures the level of fear in the market, catapulted to over 40 intra-day—only the eighth time period in the last 20 years it had done so. Two months after those August lows, the question now becomes, is the worst of the sell-off behind us? And if so, is there another leg up to this aging [bull](#) market? **Is the Correction Over?** On October 21, I said on CNBC that I now believed it was, provided that Congress votes without undue drama to pay its bills. With weak third-quarter earnings now being reported, one could make a good case that the lows for the year have already printed—especially if one believes [aggregate earnings](#) on the S&P 500 will rebound in 2016, which I do. However, the market has one more hiccup to digest in 2015: a congressional vote to raise the Federal debt limit. The last time the debt ceiling became hostage to political brinksmanship, back in the summer of 2011, the market sold off nearly 20% and Standard & Poor's downgraded the [credit](#) quality of the U.S. government. The debt limit was only raised after a tense round of high-stakes horse trading: more borrowing capacity in exchange for reductions in future spending. The uncertainty surrounding this outcome could yet unleash a new round of [volatility](#) into the system. But it would take a colossal act of legislative incompetence and political stupidity to allow the federal government to default on its debt, so I view the threat of actual default as minimal. This does not mean a deal will get done without some drama (watch for debt limit countdown clocks on cable). If the market sells off into the deadline, I would view that as a potential buying opportunity for investors with time horizons that extend at least a year into the future. **Spikes in the VIX Often Create Buying Opportunities** Over the past 20 years, spikes in the VIX have generally coincided with major market lows. This makes sense, as the VIX moves in the opposite direction of the S&P 500 when risk is being re-priced and stocks are typically being sold. More often than not, spikes in the VIX create buying opportunities for long-term investors who have the courage to buy into markets when others are selling. That may be hard to do in the moment, but the data suggests that investors have historically been rewarded for it. If we measure the total returns of the S&P 500 over the 12 months following each of the periodic VIX spikes over 40, we notice that the market was notably higher in six of the seven periods and that the average one-year

Date of VIX Intraday Spike over 40	VIX Intraday high	S&P Total Return in the Subsequent 12 months	Initial Market Low Retested? ¹
10/28/1997	48.64	17.70%	Yes
10/8/1998	49.53	41.08%	Yes
9/21/2001	49.35	-11.14%	No
7/24/2002	48.46	18.51%	Yes
10/24/2008	89.53	26.42%	Yes
5/21/2010	48.2	25.04%	Yes
8/8/2011	48	28.09%	Yes
8/24/2015	53.29	N/A	Yes
Average 12-Month Return from First VIX Spike		21%	

Sources: Bloomberg, WisdomTree. Past performance is not indicative of future results. You cannot invest directly in an index. ¹Retests are defined as a second closing low on the S&P 500 within 3% of the initial closing low the day of the VIX spike.

return over all the periods was 21%.

In seven of the last eight instances, the S&P 500 retested the VIX spike lows within four months of the first sell-off.¹ The exception was the market rally and recovery after September 11, 2001. This means that investors typically had a second chance to increase or re-establish positions once that second retest of the initial panic lows had been successfully achieved. On September 29, 2015, the S&P 500 touched 1872 intra-day— about .3% above the August 24 intra-day low of 1867. **Conclusion** Short of a debt default, I don't believe the 10% decline this summer will be the start of a new [bear market](#). Although the market is currently trading at a forward [price-to-earnings \(P/E\) ratio](#) of 16—higher than its historic average—I believe the current mix of low interest rates, low unemployment, healthy consumer confidence and consistently strong consumer spending remains supportive of further market gains. The forces that have propelled U.S. equity gains these past five years—stock [buybacks](#), [dividend yield](#) and [dividend growth](#)—remain in place, even in the face of current lackluster sales and earnings growth. *Unless otherwise noted, data source is Bloomberg.* ¹In March of 2009, the S&P 500 unsuccessfully tested the October 2008 low and fell another 10%. However, over the subsequent seven months, the S&P 500 Index nevertheless was able to rally and close 26% above the October 2008 lows.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Debt capacity : Attention to measures that have the potential to indicate if a market can take on additional debt without impacting the market price of existing debt to a large degree.

Dow Jones Industrial Average : The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Bullish : a position that benefits when asset prices rise.

Aggregate earnings : total earnings.

Credit : A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Dividend growth : The growth in trailing 12-month dividends for the specified universe.