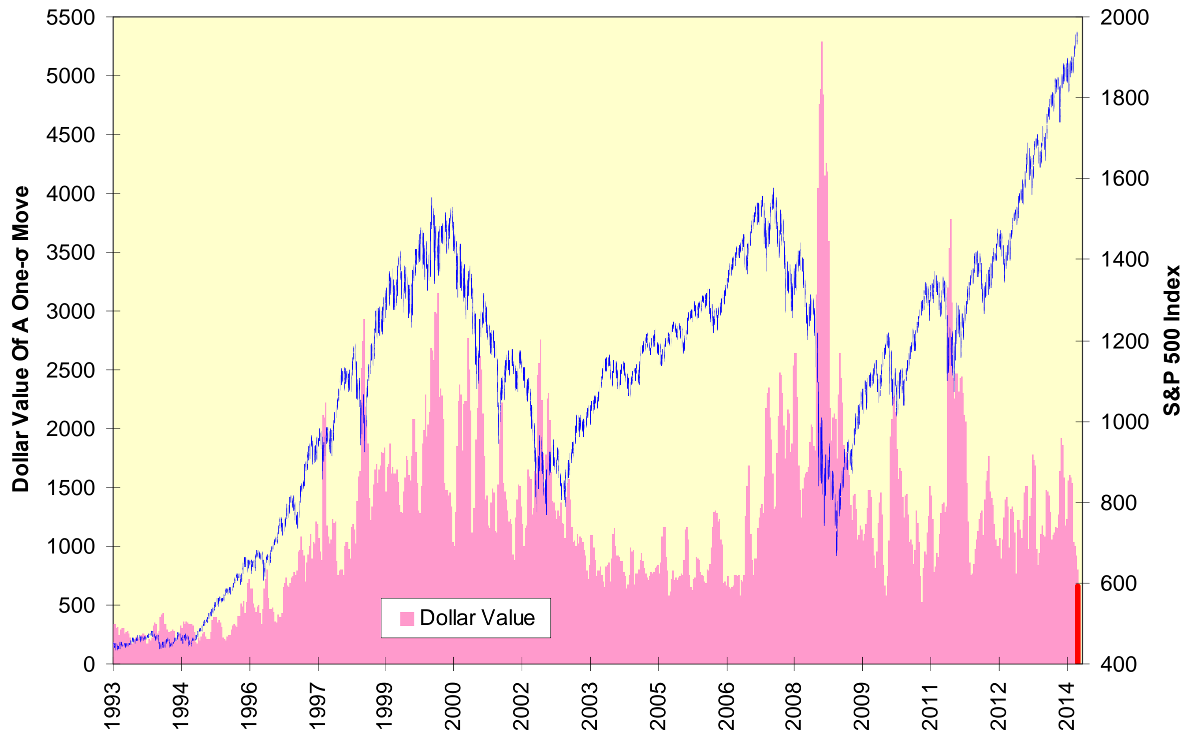
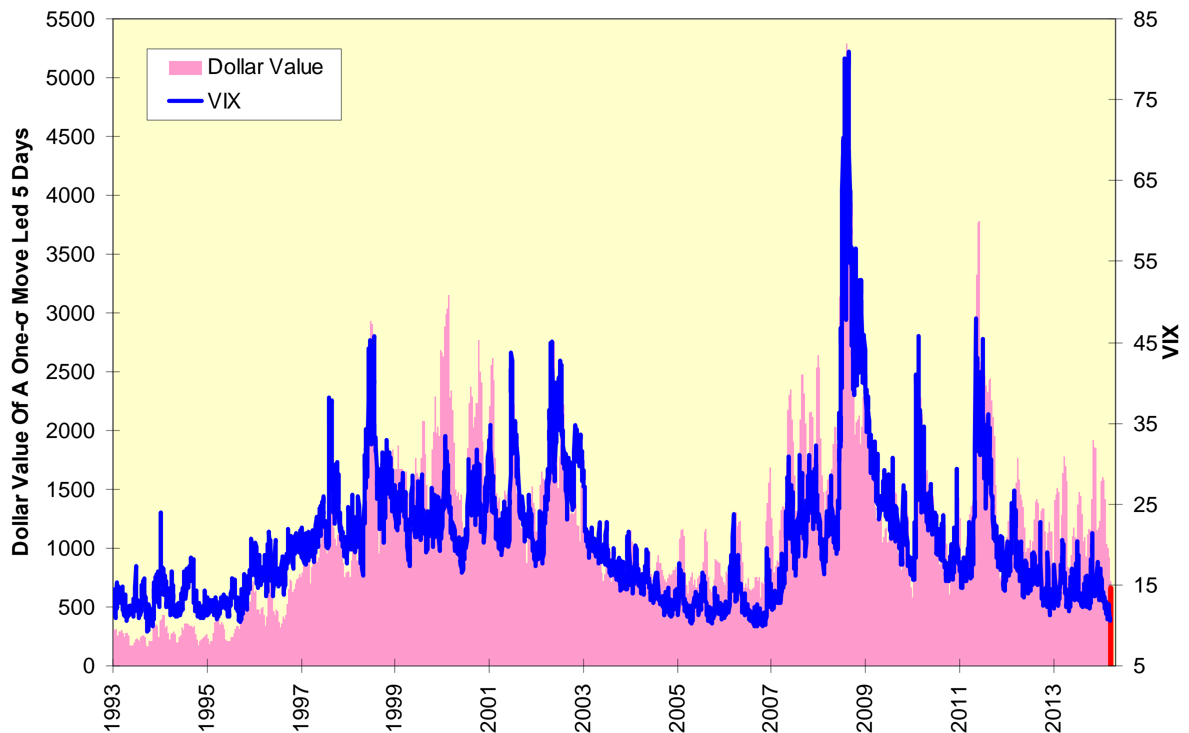
For A Correction Lasting More Than Four Hours, Call Your Central Bank

If you remember what you were doing in July 1996, it is probably for the wrong reason. We were in the second year of the spectacular late 1990s bull market, and all systems seemed "go" in both financial markets and the global economy. We were five months away from the phrase "irrational exuberance" entering the idiom, a year away from the Asian crisis and two years away from the Russian default and the implosion of Long-Term Capital Management.

We also had the same dollar value of a one standard deviation move in the S&P 500 index then as we do today even though the benchmark was trading in the 640's, less than one-third of today's level.



As I noted in May 2013, the dollar-value of a one standard deviation move is based on realized volatility and therefore is backward-looking; the VIX is based on implied volatility and is forward-looking after a fashion. In reality, the VIX leads 21-day realized volatility by five days on average, meaning "now-casting" often is present.



This will not stop the chirping about the VIX being "too low," a statement devoid of content if there ever was one. The VIX or any other measure of implied volatility has to be placed in the content of both underlying volatility and the psychological states of time-adjusted retracement of gain and proximity to last new low. Small wonder most of the noise about the VIX is coming from those who have been consistently wrong about the bull market over the past five-plus years and lack the grace to sit down and shut up out of simple decency if nothing else.

The Primacy Of Monetary Policy

As they used to say in the Army about the 175-mm self-propelled gun's accuracy, "It can't hit the same grid square twice." Speaking of the Federal Reserve's track record of crisis identification and macroeconomic forecasting, why do market commentators persist in following those insanely meaningless dots generated by the FOMC at every meeting?

Ignore the forecasts, ignore the side-by-side wording comparisons, and ignore the conflicting statements made by FOMC officials and focus on one thing and one thing only: That crowd shares the status of Admiral Jellicoe prior to the Battle of Jutland in 1916; they are the only people who can lose the war in a single afternoon and they know it. As long as they are afraid to tighten credit or raise short-term interest rates for fear of unwinding the one success of post-crisis policies, higher asset valuations, they will persist in keeping real interest rates negative out to the middle of the yield curve with the result all investors will have to keep climbing out either or both the duration or risk curves.

This means volatility will remain suppressed and the dollar value of a one standard deviation move will stay at absurdly low levels. It may and probably will end badly in the long run, but I have to side with Lord Keynes here and note that in the long run we all share the same fate.