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INVESTMENT COUNSEL

What's Normal?

It is a simple question, "What's normal?" What is regular, typical, average? Since the Great Recession, some have suggested we are in a time of the "new normal". Amidst uncertainty and change, we look for a sense of normal to anchor ourselves and our expectations. While we are admonished that past results do not guarantee future outcomes, we apply statistical measures to history for a sense of what may lie ahead. Ancient mathematicians even gave us the "normal distribution" with its "bell-shaped" curve to quantify and visualize normal. A look at concepts of normal versus actual for some economic and market measures can provide investment implications.

PERSPECTIVE

Stock markets continued their rally through April with many indexes reaching new, all-time highs. The Dow Jones Industrial Average ("DJIA") gained +14.8%. The "normal", i.e., average, DJIA gain for the first four months of all calendar years since 1897 is +3.9%. Chart I shows the "bell-shaped" curve in red that conveys the statistical frequency of historical returns. Shaded in gray is the actual frequency of returns. While the curve indicates "normal" occurred about 40% of the time, reality has been less than 30%. The good news is that there has been a bias in frequency toward higher outcomes versus lower ones. In any event, the welcome outcome of the past four months was well above expectations.

Another bit of recent good news was the announcement that the U.S. unemployment rate reached a 50-year low of 3.6% in April. This rate is well below the 5.8% "normal" that has prevailed post-World War II. Lower rates were clustered in the 1950s when U.S. economic activity was booming in the post-war period. In Chart II, we see a "bell-shaped" curve for unemployment rates, again indicating a frequency of "normal" rates around 40%. The actual frequency of unemployment rates, shaded in light blue, was quite different with no more than a 10% frequency for rates in the normal range. Reflecting the overall economy itself, unemployment rates tend to move in sweeping cycles and with less period-to-period variability than that of stock market returns.

If anything qualifies as a "new normal", it has been the general level of interest rates over the past decade. Chart III displays the frequency of average monthly U.S. Treasury 10-Year Note yields. Over the past 66 years, "normal" has been 5.8%. The "new normal" of the past decade is 2.5%, which also is the most recent level. As with the first two charts, the actual frequency of yield levels, shaded in yellow, was much different than that of the statistical "bell-shaped" curve.

INVESTMENT IMPLICATIONS

What's normal for most investors is a preference for more return and less risk. Traditional statistical measures remain useful for measuring return opportunities and risk exposures, but it is important to understand their limitations in practice. What's also normal for most investors is the pursuit of individual goals over identified time horizons and within acceptable levels of risk-taking. Concepts of "normal" and the application of statistical measures take a back seat to the uniqueness of each investor's circumstances. Once they are understood, what's normal is the pursuit of goals through a disciplined process that prudently utilizes all relevant measures

CHART I

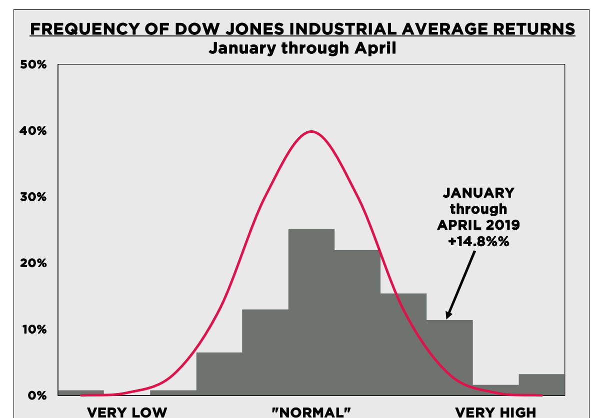


CHART II

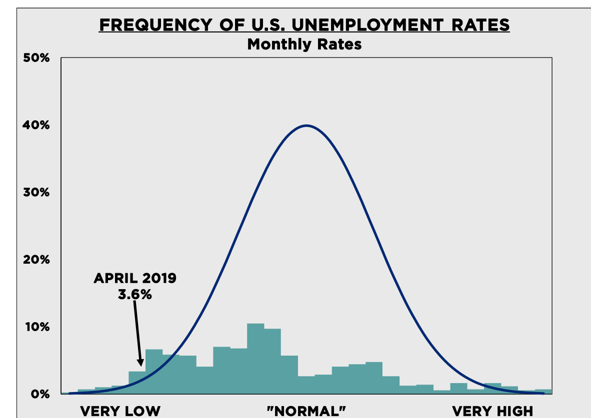
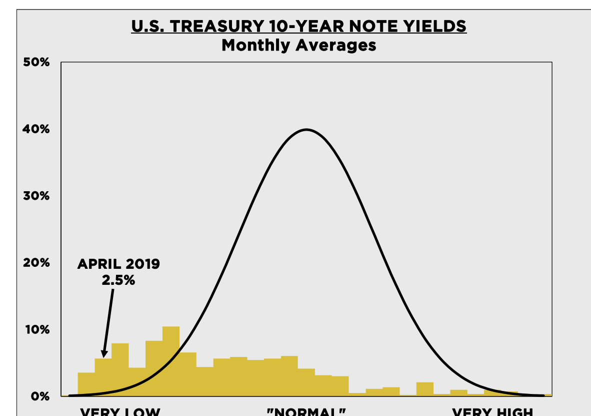


CHART III



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