Marcus & Millichap

Research Brief

STOCK MARKET

October 2018

Equity Volatility Perks Up Amid Quick Interest Rate Move; Commercial Real Estate Appeal Brightens

Developing Trends

- **Fed remains committed to tightening.** Recent comments from the Fed remain hawkish, with a rate hike planned for December and as many as three possible for next year. Core PCE (personal consumption expenditure), the Fed's preferred inflationary metric, remained at 2 percent in August, matching the Fed's objective for core inflation.
- **Unemployment hits lowest rate in nearly 50 years.** The September jobs report highlighted a slowdown in overall additions yet posted an unemployment rate of 3.7 percent, marking the lowest rate since 1969. Additionally, job openings recently totaled 6.9 million in July, while the number of those unemployed equaled just 6 million in September.
- **Higher mortgage rates hamper home sales, brighten apartment outlook.** Existing home sales fell 1.5 percent from a year ago in August as higher mortgage rates and limited inventory push up the cost of a single-family home. The downturn in home sales has benefited apartment demand, where national vacancy has fallen to the lowest level since 2001, ending the third quarter at 4.2 percent.

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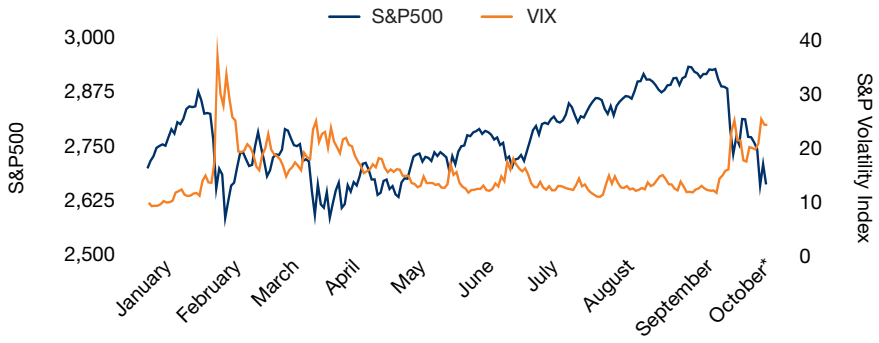
Rising interest rates, midterm elections spark equity market volatility. The stock market suffered its second largest single-day decline of the year on Wednesday, Oct. 10, contributing to a 4 percent weekly drop. Simultaneously, the S&P Volatility Index (VIX), a measure of how quickly equity markets are moving, rose from 15 to 24 in the past weeks, indicating a strong market sell-off. Both were precipitated by long-term interest rates rising rapidly earlier this month, carrying the 10-year Treasury yield to 3.25 percent from a prior trading range of 2.85 to 3.05 percent for most of 2018. These trends, in conjunction with concerns over how fast interest rates will continue to rise and uncertainty surrounding the midterm elections, caused significant selling pressure in equity markets. The sharp move in interest rates will impact the economy at various intervals moving forward, lifting the cost of debt financing and accelerating credit-related stress, raising the prospect of additional volatility in upcoming months. However, percolating wage growth, stable inflation and the lowest unemployment rate in nearly 50 years highlight a robust economy, evident by the second quarter GDP reaching 4.2 percent. Meanwhile, volatility remains a key feature of equity markets, encouraging investors to hold a diversified portfolio of assets to reduce the impact of volatility on their holdings.

Commercial real estate presents alternative option for investors. Carrying competitive yields and relatively less volatility, commercial real estate represents a viable alternative to equities. Additionally, property values typically reflect the economic strength of the real economy, underpinned by low unemployment, positive demographics and continued growth in consumer spending, reinforcing a healthy outlook for the coming year. The economic recovery has tightened vacancy significantly across all major property types, while construction in balance with demand has prompted considerable growth in rental rates.

80% Rise in the VIX from Oct. 8 to Oct. 12

1,300 Dow Point Drop from Oct. 10 to Oct. 11

Rising Volatility Accompanied Equity Move Lower



* Through Oct. 12
Sources: Marcus & Millichap Research Services; Moody's Analytics; Federal Reserve Economic Database; Bureau of Labor Statistics