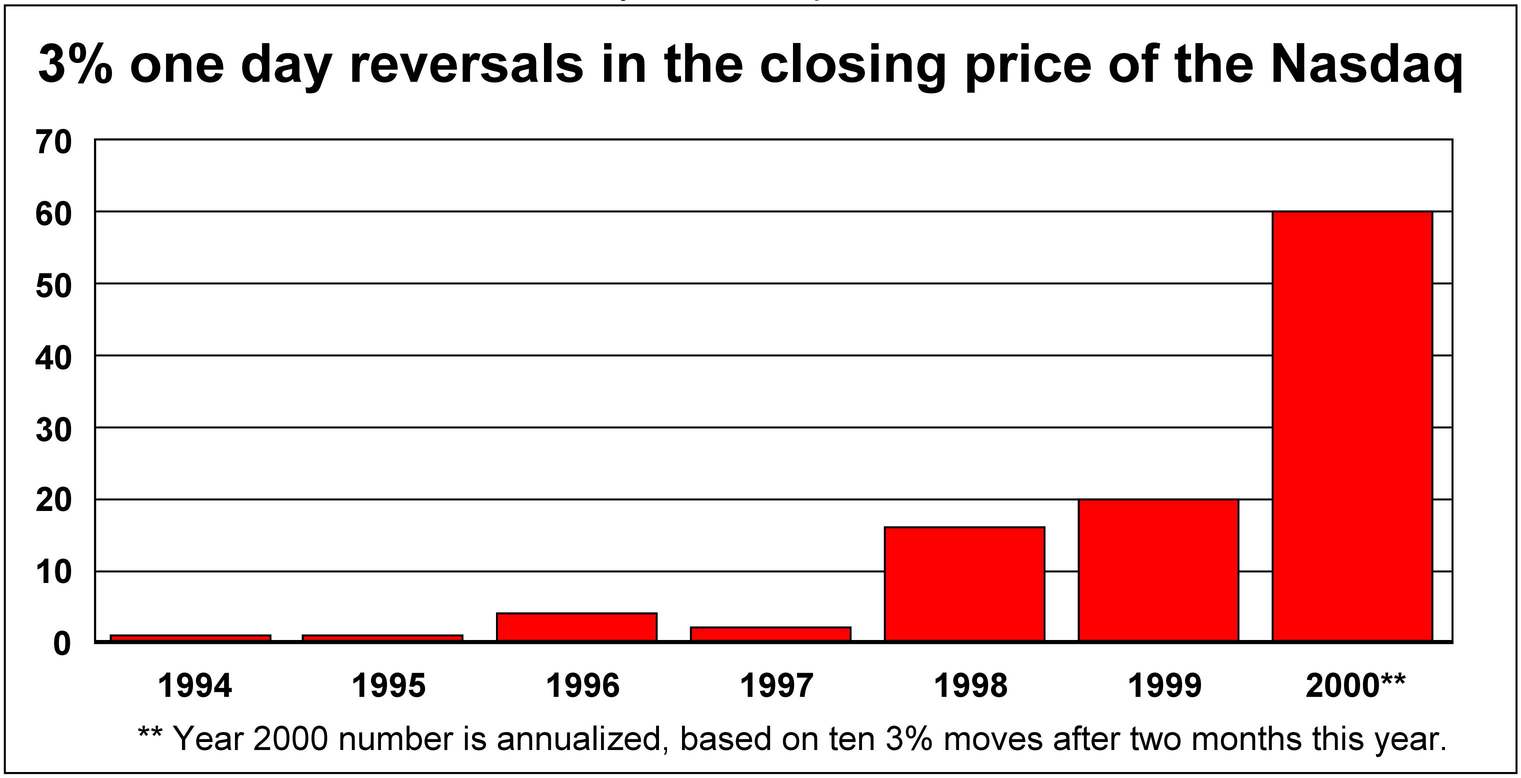
Nasdaq Volatility: How high can it go?

by Howard Spieler



The past several years has brought a virtual windfall for many investors who purchased aggressive growth, internet and other technology based equities. Most, if not all indices that track these investments came close to doubling in value (or better) last year, and have continued their spectacular performance so far in the year 2000. But, along with these huge gains in the major technology indices have come violent swings in the Nasdaq Composite, at least by historical standards. One way of measuring this volatility is to count the number of 3% one-day reversals in the Nasdaq closing price; that is days that the Nasdaq finished either 3% above OR below the closing price from the previous business day. As you can see, in 1994 through 1997, these days of high volatility were quite infrequent. (one, one, four and two respectively). By 1998 (the start of the Internet craze: coincidence?) and 1999, we saw 16 occurrences and then 20. By the end of February 2000, the Nasdaq had 10 separate instances where the closing price closed 3% above - or below - the day before. That puts us on a pace for 60 this year - far ahead of last year's already high level of 20. That averages out to more than one a week! Even by a more conservative estimate of 40, that would still give us a 3% shakeout (or blowoff) more than once every two weeks. (Please also note this does not include intraday movement, which we estimate would significantly increase these numbers if tracking intraday Nasdaq Composite high levels vs. low levels).

What does all of this mean?

The implications of this volatility are serious. It is fact that stock prices fall at a much faster rate than that at which they rise. The Nasdaq Composite has had a pretty much parabolic rise since 1994, gaining nearly 500% in four + years. What happens if - or perhaps when - technology stocks falls out of favor? Whether it is rising interest rates, inflation, overvaluation, or some other unforeseen entity, this market may yet turn viciously in the blink of an eye. It seems so long ago, but many investors have already forgotten January 4th, 5th and 6th, where the Nasdaq fell by 10% in three quick days - including a 5.55%, 229 point sell off on January 4th which precipitated a mini-correction. The potential for evil in the event of higher than present volatility in a downside market are considerable. We will all enjoy it while we can, but we cannot advise complacency.