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Synthesis

A composition that pulls together the primary themes, analysis and portfolio views from Portside Investment Advisors

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A Predictable Surprise

By many measures, global stock markets over the last year had experienced the lowest volatility ever recorded. Given history and human nature, it was unlikely to continue in the same manner. Indeed, when the markets feel as sanguine as they have, it actually increases the likelihood of major downdrafts.

Low volatility periods encourages excessive risk taking as many investment programs start taking the calm as a given. When this happens, there is usually a trigger point that forces out some of the excess. In this case, sustained low interest rates had reduced the volatility and so it was likely that if rates moved high enough fast enough it would alter the market trajectory.

The market participants being shaken out the most are traders betting on volatility remaining low. These traders were banking on a large equity being drop being virtually inconceivable. The implication for the market was that a modest drop in stocks triggers these traders to sell more which in turn accelerates the decline.

The strong fundamentals of the economy and company earnings are likely still intact. As signs of this, emerging market equities and bonds actually held up well against US markets over the last couple days. This tells you the market event was not about global economic growth slowing. Also, fixed income credit markets were relatively calm considering the equity move which also says the business cycle is probably not at an end.

There will probably be some residual turbulence over the coming days or weeks. The market is now awake to the fact that risk does exist. However, those with patience who are willing to ride the storm should be rewarded.