iguard ... a new way of thinking

SIM Market Comment on recent market volatility

November 2014

Volatility has returned to markets recently seeing much of the gains made this year disappear, with only the US marginally up in local currency terms.

This period of market uncertainty has likely been caused by a number of factors coming together at the same time:

- **Quantitative Easing is due to cease** at the end of October with no further asset purchases scheduled thereafter.
- **The US dollar has finally started to strengthen** with one of the strongest rallies witnessed over the last 30 years in the third quarter.
- **The threat of deflation has been building in the Eurozone**, with the ECB singling it out during a speech at the Jackson Hole Symposium of central bankers.
- **An unexpected fall in the oil price** - the price of WTI oil falling from $106 a barrel to just under $82 in short order, with Brent following closely behind.
- **Bond yields have dropped significantly**, with even the UK 10 year Gilt breaching 2% which is now well below anyone's expectations following a fall of 0.35% last Wednesday. A move of such magnitude that hasn't been witnessed since the dark days of 2008/09.
- And if all this wasn't enough, **Ebola has become a genuine global concern**, which only at the beginning of the summer newspapers were saying would never spread beyond Africa. Oxfam have recently suggested it could be the "disaster of our generation".

At a time when few if any risk assets can be described as cheap the combined effect of these factors has significantly affected market confidence.

So has global growth data deteriorated to help explain this turbulence? Germany's growth has certainly slowed down, impacted by weakness in some of its key exporting markets. There have also been downward revisions to GDP forecasts within the rest of Europe. However, this has equally been offset by slight upward revisions in the US and even within China and there are several reasons to remain positive:

- **The housing market recovery in the US continues**, and the strengthening dollar for an economy which is very much domestically led is overall a positive, keeping the price of imports down and inflation low.
- There are good reasons to believe that the **weakness in the oil price is as much a consequence of supply as demand**. Shale oil in the US, continued oil production within both Iraq and Libya despite the rising levels of conflict within these countries have all added to a positive supply outlook.
- **The weakness of the Euro** which has now depreciated almost 10% versus the dollar since the end of April is a very significant positive for a trading block who derive 65% of their profits from outside of the area.

So will markets continue to behave as they are? The global economy continues to recover, but growth is unlikely to recover to the levels seen pre 2007 as global indebtedness holds expansion back. Consequently inflation is likely to remain relatively low, leading to interest rates remaining lower for longer than historically has been the case; both of which are positive for equity performance. But nonetheless as currently both the US and UK are operating under emergency rates we think it is only a matter of time before the first interest rate rise. And whilst we are in the current environment, although we think markets will produce positive returns for investors, they will likely experience similar bouts of nervousness. Investors will need to get used to two steps forward, one step back for quite some time to come.