UNDERSTANDING THE CURRENT MARKET VOLATILITY

Financial markets started the week off with an acute negative tone. A Monday sell-off in Asian equity markets extended in a wave through Europe and over to North America. The risk-off sentiment was pervasive, as equities and commodity values shrank, while a flight-to-safety trade pushed bond prices up amidst lower yields.

Whether officially in a correction or bear market territory, many markets watched early 2015 gains evaporate. The drop in commodity prices is significantly affecting resource-heavy economies, like Canada. Oil prices dropped below $39/barrel (WTI), values not seen since 2008.

Equities (local currency, price only, % change),
as of 12:15p.m. (EST), August 24, 2015. Source: Bloomberg

	8/24/2015	Week	QTD	YTD
S&P/TSX Composite	13305.38	-6.64%	-8.58%	-9.07%
S&P 500	1945.77	-7.45%	-5.69%	-5.49%
NASDAQ	4679.89	-8.09%	-6.16%	-1.19%
DAX	9648.43	-11.81%	-11.85%	-1.60%
CAC 40	4383.46	-12.06%	-8.49%	2.59%
FTSE 100	5898.87	-9.95%	-9.54%	-10.16%
Nikkei 225	18540.68	-10.09%	-8.38%	6.25%
Shanghai Comp.	3209.91	-19.63%	-24.95%	-0.77%

A number of global economic and geopolitical factors have contributed to markets being on edge, but the epicenter of issues sparking the current market sell-off is China. The specific issues were the busting of the Chinese stock market bubble and growing concerns over the Chinese government's ability to sustain Chinese economic growth.

It is far from new news that the Chinese economic growth rate is slowing, but in spite of this, the Shanghai Composite stock market continued its dramatic rise into 2015. The stock market rose more than economic realities warranted. At GLC we've long been saying that the dramatic rise in the Shanghai Composite was not sustainable. It was a market bubble, and a correction was overdue. The Chinese market bubble came to an abrupt halt in the second quarter of 2015. As stocks plunged, the government decided to intervene and put in place a number of extreme stop-gap measures. While those measures temporarily dampened the extreme market volatility at the time, they were insufficient to either build global confidence in the Chinese government's ability to maintain its targeted economic growth rate, or stabilize its equity markets. This negative sentiment reached a tipping point over the weekend.

Source: Bloomberg

KEEPING PERSPECTIVE

Stock market corrections, while never fun, are a healthy and normal part of a market cycle. While the Chinese stock market bubble was due to burst, it does not mean that the rest of the world is in the same boat. Within North American markets, the sell-off appears indiscriminate: not only pressuring stock values in which valuations have been stretched, but also over-punishing stocks in which valuations had already reflected much of the negative sentiment towards China's economic growth rate.

What is more relevant to Canadian investors is what recent events mean for global economic growth going forward. With the prospect of global growth slowing, commodities have seen a significant re-pricing. This has been going on for some time with companies and investors re-adjusting their expectations for future earnings along the way. We do not believe that sub-$40 oil values are sustainable over the long-term, and with all stock prices being punished, we believe that attractive opportunities will emerge.

The U.S. economy remains significantly healthier today than prior to the 2008/2009 financial crisis. Banks and U.S. households both have much stronger balance sheets than they have had in years. We expect continued market volatility around the timing of a Fed rate lift-off, but we do not foresee the U.S. economic recovery being derailed. We continue to expect to see global economic growth, perhaps slower growth, but growth none the less.

We expect further volatility in the coming days and weeks, and volumes are notoriously low in the summer (adding to market volatility). Not all stocks are 'bad', and corrections like today's can often cleanse the waters for portfolio managers to add to or pick up high-quality companies with strong prospects for price appreciation. This is an opportune time as positions in those companies on our portfolio managers' watch list, whose prior valuations were too high for their given growth prospects, can be added over time as the market essentially 'goes on sale' with the current sharp correction. This is exactly when GLC's active portfolio management and disciplined investment processes shine - allowing us to find attractive opportunities amidst, and in spite of, market noise and volatility.