MVAM Newsletter

Viva la volatility July 2015

Trading volumes in equity markets have tumbled in the last month or so, whilst at the same time the volatility of share prices has soared. The volatility is understandable. One week the UK and US are booming, wages are rising, and core Europe is recovering. The next week, Greece is leaving the Euro, China is slowing and the threat from the Islamic State has become terrifyingly close to home. But why the fall in trading volume? Well in short, such mixed news has made investors increasingly uncertain about the immediate future and, like a rabbit caught in the headlights, the first shock reaction is one where they become rooted to the spot, unable to act. Fear takes over.

What happens next is more of a choice. If nothing changes and the truck keeps coming, the fear continues to mount and when we are afraid we tend to want to run as far from the risk as we can. It's a natural defence mechanism. Hence, when markets are so volatile, we shouldn't be surprised that many investors will succumb to that fear, sell their holdings and look to hide in cash. So equity markets have been under pressure. The FTSE 100 lost 5% in June, and has now given up most of its gains this year.

But this is an emotional response rather than a rational one, and making emotional decisions when investing in equities is rarely successful. An alternative reaction when markets are so volatile, is to simply do nothing and hope that the truck passes safely by (after nothing more than a sharp swerve), on the hope that "markets will recover, they always do". That may seem more rational. After all, this isn't the first period of volatility that we've seen in equity markets and, in the long term, we know that sense will prevail and trends will re-establish themselves. But, as the comic actor Leslie Nielsen once said "doing nothing is very hard to do…you never know when you're finished". At what point do you become sufficiently re-assured to start buying or selling again?

So perhaps an even better way to deal with volatility is to take advantage of it when it arises. In fact, markets that are bouncing around from one day to the next can provide numerous opportunities. It's a matter of holding your nerve and buying the shares where you have strong conviction (and many shares will be unaffected by these short term events) and selling those holdings where there appears to be 'irrational exuberance'. For example, if you had sold the UK market on the post general election euphoria, then you would have saved yourself 6%! What is important is to stay alert and watch out for those opportunities and that's where, as a team of experienced professionals, we can really make a difference.