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Market Update
August Volatility

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What happened?

Monday 5 August saw a global sell off across risk assets, led by losses in Japan and the wider Asia region. The Japanese stock market saw one of the largest impacts, with the Tokyo Stock Price Index (TOPIX) closing the day down 12%, its largest single day fall since the "Black Monday" crash of 1987. This contagion spread to other Asian markets, as well as into Europe and the US, with the S&P 500 Index falling over 2%, and the VIX index (measuring the implied volatility on S&P500 options) rising to its highest value since the covid-crash of 2020.

Why has this happened?

As with many market moves, rather than a single factor in isolation, a number of events have driven these latest developments. These are as follows:

- **Concern over US jobs data** – On Thursday 1 August it was reported that the US labour market had added only 114,000 jobs in July, as the unemployment rate rose; a far weaker result than expected. This has led to concerns that the Federal Reserve has been too slow in pivoting to lower interest rates, having opted once again to hold the Federal Funds rate at 5.25%-5.5% following its late July meeting.

- **Falls in the value of US technology stocks including the Magnificent 7** – For quite some time many investors (including ebi) have been concerned about how a handful of US mega-cap technology stocks, the Magnificent 7, have grown to such a large size (with these 7 stocks accounting for c.20% of the entire MSCI ACWI Index of Developed and Emerging Stocks as at end-June 2024) while also accounting for the majority of market returns over recent time periods. Last week saw these concerns crystalise across the wider market, with a tech sector sell off prompted by an announcement that the chipmaker Intel was planning to cut c.15% of its workforce, and concerns that the prior excitement around the AI boom and the demand for specialised chips has been overplayed.

- **Tightening Japanese monetary policy and the impact on the yen carry trade** – On Wednesday 31 July the Bank of Japan made the decision to tighten its monetary policy, through raising its benchmark interest rate to 0.25% (its highest level since late 2008), and outlining plans to halve its monthly bond purchases. This resulted from concerns regarding the continued decline experienced in the value of the yen against major global currencies such as the dollar, following years of negative interest rates (with Japan only exiting its negative interest rate regime in July). However the knock-on impact of the decision to raise interest rates has been significant – for years many investors have been taking advantage of the yen carry trade – borrowing cheaply in yen, and buying riskier overseas assets (such as US technology stocks) with the proceeds – increasing the interest rate has dealt a blow to the profitability of this trade, leading to a large number of investors seeking to exit the trade and unwind their positions. When combined with falls in the values of some of the underlying assets being bought, such as US technology stocks (as outlined in the prior bullet point), a quite explosive market set-up occurred, with investors rushing to the exits all at once.

What's the latest situation?

Tuesday 6 August saw a significant stabilisation in markets globally, with markets in Asia reversing much of Monday's sell-off (with the TOPIX rising c.9%), as well as the S&P up around 1%. This serves to show just how volatile markets can be, and just how challenging market timing is to deploy effectively. Tuesday's recovery has been supported by expectations that the Federal Reserve will now cut rates more quickly and to a greater extent than previously thought (with the CME FedWatch tool now indicating a two-thirds likelihood of a 0.5% rate cut at the 18 September Federal Reserve meeting), as well as investors stepping back into the market to pick up assets at significantly lower valuations than seen just a few trading days ago.

What's the outlook?

While stability has somewhat returned, markets aren't necessarily out of the woods yet and its possible we see further market volatility over the coming days or weeks, for example resulting from announcements of a major market participant winding up operations resulting from stresses from this week's volatility. Nonetheless, our view remains the same as previous bouts of market volatility (for example in 2020) – we believe it's near impossible to consistently effectively time the entry and exit of markets around these movements, and that the vast majority of investors are best served by simply maintaining their long-term view, as set out in their strategic asset allocation, holding through these events and only rebalancing their portfolio as and when pre-determined tolerance thresholds are breached and indicate a rebalance is optimal.

We will continue to closely analyse and report on market events such as these as and when they occur, however if you would like any further information in the meantime then please don't hesitate to let us know.

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