

## Higher volatility... but fundamentals remain unchanged

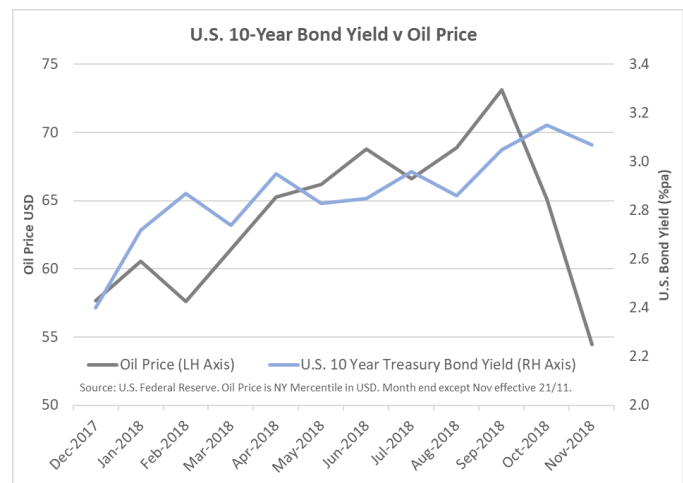
The 7% average decline across global equity markets in October has been followed up by a period of further financial market volatility over the first 3 weeks of November. Days in which share markets have moved by more than 1% have become more common over recent weeks, with the following net movements recorded so far in November (as at the 21<sup>st</sup>):

- The Australian S&P ASX 200 Index has fallen 3.3%
- The United States S&P 500 Index has fallen 2.1%
- The German DAX Index has fallen 3.3%
- The global oil price has plummeted 16.9%, following an 11.5% decline in October
- The \$A has appreciated 1.3 cents against the \$US
- The U.S. 10-year government bond yield has fallen from 3.15% to 3.07%

### How to interpret the recent spike in volatility

The combination of lower oil prices, lower bond yields and falling equity markets would normally be associated with a prevailing view that the outlook for economic growth and company profitability had weakened. However, there is little tangible evidence of any change in the broader economic outlook, with the latest U.S. company reporting season characterised by ongoing strong earnings growth. More likely, what has been experienced in November is an “after shock” on investor sentiment stemming from the October correction, with the instability in the oil price acting as a catalyst for wider volatility. There is also the possibility that the confirmation of the Democrats winning a majority in the U.S House of Representatives has created a view that government expenditure programs will be more moderate. This could explain some of the softening of the \$US and bond yields.

Outside of the direct impact on the energy sector, the decline in oil prices could be viewed as being positive for equity markets more generally. A lower price of energy reduces input costs for businesses and also takes some pressure off inflation. Given that rising inflation and rising bond yields are two of the major risk factors associated with investing in equities, the fall oil prices, whilst unsettling, is not necessarily a negative for share markets. In addition, the decline in the value of the \$US could be viewed as having a favourable impact on U.S. company earnings as well as dampening the risk associated with emerging markets, which had been sold down earlier this year in response to capital outflows associated with a stronger \$US. However, the significance of the changes on financial markets over the past 3 weeks should not be exaggerated. Whilst higher volatility and negative sentiment is cause for some caution, fundamentally little evidence has emerged that would justify a material change to longer term investment positioning.



### Important Information

The following indexes are used to report asset class performance and calculate the benchmark returns for this model portfolio: ASX S&P 200 Index, MSCI World Index ex Australia net AUD TR (composite of 50% hedged and 50% unhedged), FTSE EPRA/NAREIT Developed REITs Index Net TRI AUD Hedged, Bloomberg AusBond Composite 0 Yr Index, Barclays Global Aggregate (\$A Hedged), Bloomberg AusBond Bank Bill Index, S&P ASX 300 A-REIT (Sector) TR Index AUD, S&P Global Infrastructure NR Index (AUD Hedged).

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