Volatility is wake-up call for investors after remarkable run

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Markets Insight

The volatility of the past two weeks in financial markets should serve as a timely wake-up call to return-hungry investors who had driven stock valuations to record levels, comforted by ample and predictable central bank liquidity injections.

Not only are the liquidity injections proving less potent in reliably overcoming a weakening economic recovery and less responsive fiscal policy support, but there are no easy ways to protect portfolios against major sell-offs. That is due to the distorted nature of today's markets. Government bonds and gold, the principal tools for portfolio risk mitigation, have offered little protection recently to investors looking for diversification.

The rollercoaster ride in stocks is combining with signals of future large fluctuations in derivatives markets to raise doubt about the future. It is no longer clear that this is a short-term "healthy correction" that cleanses markets from excessive risk positioning and strengthens the foundation for further gains. More people are concerned we may have started a more sinister adjustment process that pulls asset prices down closer to what the underlying economic and corporate fundamentals would support.

After a remarkable run, investors have been dealing with a more uncertain and unsettled situation. Portfolio positioning to anticipate volatility has expanded well beyond stock options to involve most other market segments.

Many point to the US presidential election and economic uncertainty as drivers of the volatility. These included the decisions by France, the UK and other European governments to U-turn on economic reopenings in the face of concerns about a Covid-19 second wave.

But the principal cause lies in a subtle change in the main driver of what still is a remarkable stock market performance historically — liquidity and the investor conditioning it has engendered.

Having long been comforted by the ample support provided by big central banks, markets benefited from an additional funding influence that turbocharged performance this summer. New ways of investing have encouraged smaller investors to put more money into the market. Among them are user-friendly interfaces offered by providers such as discount brokerage Robinhood and spreading fractionalisation of share ownership including the opportunity to buy a basket of shares for as little as $5.

> Recent muddled moves could signal vulnerability to price pressures that may prove problematic

The marketwide impact of that influence has waned in recent weeks but retail investors are still able to move individual stocks. The change has given more courage to bearish investors who have wished to challenge elevated valuations. At the same time, the US Federal Reserve's oral communication has included some unsettling and unspecific language about the economic outlook and the policy response.

No wonder the initial market enthusiasm about the more dovish-than-expected statement after the Fed's last monetary policy meeting gave way to discomfort about the breadth and effectiveness of its stimulus support.

Investors should not expect improving economic and corporate fundamentals in Europe and the US. Recent economic data confirm what started as a V-shaped recovery is now proceeding at a much slower pace.

Investors also should not expect US lawmakers to come to the rescue. An initially impressive policy response is proving harder to sustain and not just due to political polarisation. Other countries are losing policy flexibility as growth slows, debt increases and burden sharing becomes more complicated.

Key questions in the next few months for investors include whether the Fed will reassert control over the market narrative; will new sources of market inflows materialise? And will traders continue to discount a lengthening list of economic and political uncertainties?

In answering these questions, I am reminded of an insight from Bill Gross, my former colleague at Pimco and the fund management firm's co-founder: To succeed as an investor, one needs expertise on economic and corporate fundamentals, investment maths, and a fine-tuned gut feeling. Today, the first two are flashing yellow if not red for many investment opportunities. But it is the third that matters most at this juncture.

My analytical side tells me markets' recent muddled moves could well signal greater vulnerability to price pressures that may prove problematic this time round. My behavioural side reminds me that market participants have shown a repeated willingness to believe that historically unsustainable valuation levels will prove sustainable. My strong inclination is to side with the analytics.

The writer is Allianz's chief economic adviser and president-elect of Queens' College, University of Cambridge

The day in the markets

What you need to know

- **Europe's region-wide equity index has best day since June**
- **US stocks join global rally, led by financials**
- **Pound jumps nearly 1 per cent against the dollar**

European stocks had their best day since June yesterday and led a global equity rally driven by investors scooping up shares in beaten-down sectors as a choppy month drew to a close.

The region-wide Euro Stoxx 600 index climbed 2.2 per cent, its best showing in three months. Frankfurt's Xetra Dax posted a 3.2 per cent gain and London's FTSE 100 rose 1.5 per cent.

Financials led the way, reversing a sell-off last week that pushed the Stoxx banking index to the lowest level since at least the late 1990s.

Lenders including Deutsche Bank, Commerzbank and BNP Paribas climbed more than 5 per cent. Other sectors that had been under pressure, such as travel and leisure, also gained.

US equities joined in the rally. The S&P 500 gained 1.5 per cent by midday in New York, led by financials. Bank of America's shares were up 3 per cent and Citigroup's almost 4 per cent.

"It's a risk-on trade that benefits value stocks, financials, cyclicals — the 'back to work' stocks compared to the 'work from home' stocks," said Michael Mullaney, global head of research for Boston Partners, a fund manager.

The action reflected an easing of concern over recent coronavirus cases and emerging signs of inflation, Mr Mullaney said. "Anything that is somewhat indicative of more inflation on the horizon benefits financials."

Market sentiment was bolstered by data that showed profits among China's industrial companies leapt 19.1 per cent in August from the same month in 2019 — the latest sign that the vast economy was rebounding from the effects of coronavirus.

Sebastien Galy, macro strategist at Nordea, said investors were in "buy-on-dip mode" and that markets had not "yet reached the bottom".

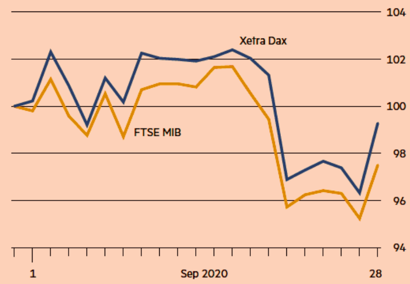
He said the gains yesterday might have been flattered by fund managers purchasing equities to rebalance their portfolios at the end of the month.

Stocks in the Asia-Pacific region had an upbeat start to the week with Hong Kong's Hang Seng up 1 per cent, Japan's Topix 1.7 per cent higher and China's CSI 300 up 0.3 per cent, in an extension of the tech rally that bolstered Wall Street on Friday.

In currencies, the pound jumped nearly 1 per cent against the dollar to just below $1.29 as analysts said they were paying close attention to developments on Brexit talks. **Camilla Hodgson and Richard Henderson**

European stocks join global rally

Indices rebased



Source: Refinitiv

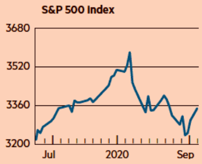
Markets update

	US	Eurozone	Japan	UK	China	Brazil
Stocks	**S&P 500**	**Eurofirst 300**	**Nikkei 225**	**FTSE100**	**Shanghai Comp**	**Bovespa**
Level	3347.87	1410.14	23511.62	5927.93	3217.53	96161.58
% change on day	1.50	2.18	1.32	1.46	-0.06	-0.86
Currency	**$ index (DXY)**	**$ per €**	**Yen per $**	**$ per £**	**Rmb per $**	**Real per $**
Level	94.203	1.165	105.625	1.284	6.821	5.599
% change on day	-0.464	0.258	-0.014	1.023	0.022	0.499
Govt. bonds	**10-year Treasury**	**10-year Bund**	**10-year JGB**	**10-year Gilt**	**10-year bond**	**10-year bond**
Yield	0.661	-0.528	0.021	0.201	3.115	7.104
Basis point change on day	0.900	0.200	1.430	1.200	0.700	-4.100
World index, Commods	**FTSE All-World**	**Oil - Brent**	**Oil - WTI**	**Gold**	**Silver**	**Metals (LMEX)**
Level	371.54	42.28	40.49	1859.70	22.63	2922.00
% change on day	1.52	1.05	0.97	-0.11	1.85	0.20

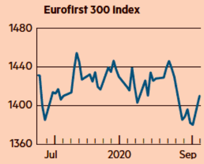
Yesterday's close apart from: Currencies = 16:00 GMT; S&P, Bovespa, All World, Oil = 17:00 GMT; Gold, Silver = London pm fix. Bond data supplied by Tullett Prebon.

Main equity markets

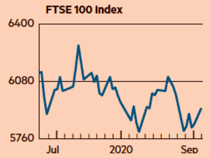
S&P 500 index



Eurofirst 300 index



FTSE 100 index



Biggest movers

%	US		Eurozone		UK	
Ups	Devon Energy	11.73	Klepierre	11.71	Hsbc Holdings	8.89
	Arconic	7.92	Arcelormittal	10.92	Land Securities	7.85
	Boeing	6.22	Aegon	7.99	Natwest	7.71
	Apache	6.09	Deutsche Bank	7.35	Lloyds Banking	7.58
	Loln National	5.91	Natixis	7.24	Standard Chartered	7.48
Downs	Dexcom	-2.52	Seadrill	-4.36	Rolls-royce Holdings	-3.55
	Westrock	-1.98	Siemens	-1.54	Gvc Holdings	-2.30
	Regeneron Pharmaceuticals	-1.88	Atlantia	-1.15	Flutter Entertainment	-2.01
	Norwegian Cruise Line Holdings Ltd	-1.35	Kerry Grp	-0.91	Glencore	-1.67
	Akamai	-1.33	Iliad	-0.87	Polymetal Int	-1.58

Prices taken at 17:00 GMT Based on the constituents of the FTSE Eurofirst 300 Eurozone

All data provided by Morningstar unless otherwise noted.

Wall Street

Boeing stood out in a broad market rally with its shares boosted by growing optimism that the grounded 737 Max jet would return to service this year.

Alembic Global Advisors upgraded the stock to "overweight" from "neutral" on expectations that European regulators would allow the 737 Max to resume flying in November. Boeing shares have lost about 50 per cent since the start of 2020.

Virgin Galactic soared after Bank of America initiated coverage of the stock with a "buy" rating and a $35 price target — the highest target among Wall Street analysts, according to Refinitiv.

The space flight company's "growth potential is unparalleled", Bank of America said. Analysts at Susquehanna also took an upbeat view, starting coverage with a "positive" rating.

Uber rose after a judge ruled that the ride-hailing group could continue operating in London, one of its biggest markets worldwide.

Shares in **Workhorse Group** jumped in another day of volatile trading for the electric vehicle company. The stock was up as President Donald Trump viewed Lordstown Motors' Endurance pick-up truck at the White House. Workhorse owns a stake in Lordstown, which said last week that it had 40,000 pre-orders for the battery-powered truck.
Matthew Rocco

Eurozone

Sonova shares jumped after the hearing aid provider raised its guidance for the financial year as business picked up quicker than expected since July.

The Swiss company revised sales guidance higher for the first half of its financial year to reach about 79 per cent of the previous year and then return to growth in the second half of the year to March. The bright outlook lifted Danish competitor **Demant**.

ArcelorMittal rallied after announcing that it would sell the bulk of its US assets to rival Cleveland-Cliffs for $1.4bn in a shares-and-cash deal.

Nearly all of the cash proceeds from the disposal would be spent on share buybacks, it said. Citi analysts said the deal was likely to be "margin-accretive" since they estimated that its remaining North American assets earned more per tonne of steel than the assets up for sale.

Siemens Energy fell on its debut day in Frankfurt, although it recovered some of its early losses in a volatile session.

Commerzbank rose after Deutsche Bank's head of German retail banking, Manfred Knof, was appointed as chief executive.

Jefferies analyst Martina Matouskova said selecting Mr Knof was a positive move because he was "accredited with the successful turnaround of Allianz Deutschland". *Harry Dempsey*

London

HSBC made its biggest daily shares gain in 11 years after its biggest shareholder, Ping An Asset Management, enlarged its stake in the bank.

The dual-listed company led the rebound for financials including **NatWest**, **Lloyds** and **Standard Chartered**, which fell heavily last week on broader fears over a resurgence of Covid-19.

William Hill tumbled after it confirmed it was in advanced discussions with US casino operator Caesars Entertainment over a takeover that would value the UK bookmaker at £2.9bn.

Greg Johnson, analyst at Shore Capital, said the offer was "far too low" and that accepting it would be "folding too early given the long-term potential in the US".

Spirits maker **Diageo** rose after saying it expected sales and operating profit to improve in the first half of its fiscal year compared with the previous six months.

Publisher **Reach** bounced after proposing a bonus issue to shareholders instead of a cash dividend.

The owner of the Daily Express reported a better than expected performance in the first half, helped by a strong recovery in digital advertising.

The purchase of a 5.35 per cent stake in **Great Portland Estates** by KKR, the private equity group, lifted the London office landlord. Rival **Derwent London** also rose on the news. *Harry Dempsey*