AMG News Flash

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Fierce fluctuations in the financial markets of late

You may have noticed the unusual volatility in the global financial markets in recent weeks, especially about the collapse in stock markets around the world. Here, we would like to offer our views and some information for your reference.

1. Global financial markets update

In the last few weeks, stock markets in different countries, crude oil prices and industrial metals prices all went into a freefall. While at the same time, the yield of U.S. Treasuries bonds, the safe heaven asset, fell hard. Take 10 years Treasuries bond as example, the yield fell to 2.4%, the lowest level in the last 2 years. And the gauge of investors' appetite for risk, VIX index* jumped above 30 points level.

*VIX index generally rises when investors' appetite for risky assets declines and vice versa.

We think that the fluctuations could be attributed to the following factors.

1. Downgrade of the credit rating of U.S. Fed government by S&P
2. Contagion of the European debt crisis to Spain and Italy
3. Investors' worry about global economic growth

First, we would like to talk about the credit downgrade of the U.S. Federal government by S&P. S&P has made its decision about the Federal government, but there is still uncertainty here. Some States government and semi-governmental enterprise e.g. Fannie Mae, Freddie Mac, FDIC…etc, are relying heavily on the Federal government for funding or financing. So, they should be next in line for credit downgrades. Yet, S&P did not tell what it will do with those entities. Besides, some European nations such as France, Italy and Spain are also straddled by a heavy debt burden. Obviously, they should be at risk too. Still, investors may take a breath if history is a good reference. There were examples in the history for some countries to lose the top rating such as Japan and Australia. But, they had no problem paying back the debt and interest even after the downgrade. Thereby, we do not expect the credit downgrade of the U.S. government to bring along any real problems.

However, investors should not under-estimate the other 2 issues.

For the European sovereign debt problem, it has always been a headache for the financial markets since Greece asked for help last year. But, the "rescue plan", which is essentially the provision of short-term financing, did not help to solve the problem. It is just buying time for the debt burdened countries to consolidate their public finance. The European sovereign debt problem remains a significant threat to the global economy and financial markets.

And the development of late was nothing desirable. Last month, the European nations agreed to the "soft" restructuring of Greek government debt. Private investors were asked to take part and bear some of losses, it hurt investors' confidence. And the contagion of the sovereign debt problem to Spain and Italy was adding to the plight. The yield of 10 years government debt went over 6% for both countries. Rapidly rising cost of borrowing was posing a serious threat to their ability to stand on their own feet. Fortunately, ECB stepped in to purchase Spanish and Italian government debt in the secondary market and quenched the escalation in their borrowing cost. Yet, there is only one real solution for the problem. The European government must bring down their budget deficit and tidy up their balance sheets. The problem is, it takes time to do so. In other words, the European debt problem will continue to cloud the market in the foreseeable future.

And for the concerns about weakening global economy, it is related to the disappointing economic figures reported in the last few months. The figures that we are talking about include U.S. job data, industrial production figures of different countries and the manufacturing PMI indices of the major economies such as U.S., Europe, China…etc. The latest figures showed that the global economy is still growing marginally, but the rapid deterioration is nonetheless drawing a lot of attention. Moreover, some of the figures are forward looking in nature e.g. the manufacturing PMI. So, they are saying that the global economy is heading to further slowdown.

It has been very unfortunate that all these problems occurred at the same time, and the atmosphere in the financial markets turned sour as a result. The fact that the U.S. and European governments are under pressure to trim their spending and national debt makes the situation even more complicated. And panic selling, at least in our views, was therefore resulted. The prices of many different kinds of assets just fell fiercely. Under the current situation, we think that investors should not let the sense of fear take over rational thinking. Rather than selling all investment to get a sense of security, you better try to calm down and think thoroughly about your investment.

Now we would like to talk about Brazil, which has been lagging behind other emerging markets for some time.

2. Brazil market update

For Brazilian market, we think that the sluggish performance was related to 4 major factors as listed below.

1. Currency appreciation hurts exports competitiveness.
2. Aggressive interest rate hike leads to economic slowdown.
3. Pullback of commodities prices holds back Brazilian exports.
4. Government intervention to curb capital inflow.

The above factors are all negative to Brazilian economy. For the stock markets, rising capital cost and the government policy to block foreign capital inflow added to its plight.

As for the poor performance of late, it has a lot to do with the decline of the natural resources names. Since the decline was caused by concerns about the strength of the global economy, naturally commodities and natural resources stocks were shunned. For BOVESPA index, the 2 biggest constituents namely Vale (14% weighting) and Petrobras (13% weighting) lost more than 13% in the last 2 weeks. It, in turn, led to a 10% strong decline for the index.

All in all, the government policy and declining commodities prices are pressuring on the Brazilian stock market. And we expect Brazil to remain a laggard among all emerging markets.

Lastly, we are very happy to share with you our thoughts and the information about the market. And we hope that by sharing the information when the market is volatile can help your make better decisions. And our financial advisers would be glad to help if you would like to know more about our investment strategy or anything about this article.

For any comments, please send email to us at enquiries@amgwealth.com.

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