Melting Moments

Understandably, market volatility unnerved investors this week, with the ASX200 breaching the 5,000 level for the first time since July 2013. It is, however, important to acknowledge that volatility is part and parcel of the stock market, and the very thing that makes the market such a fascinating beast to analyse.

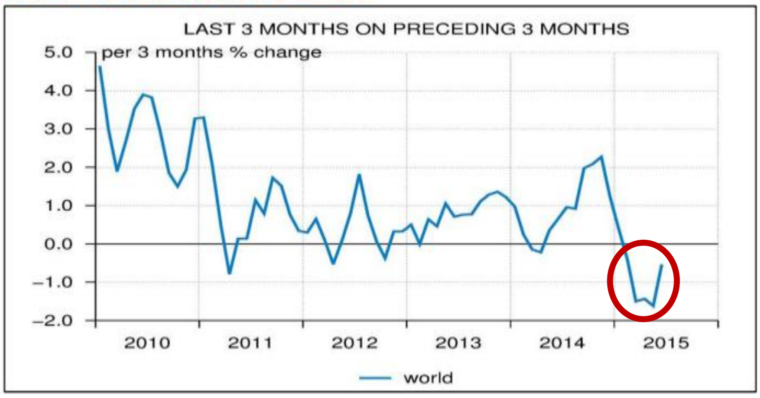
In fact, the stock market has exhibited such a lack of volatility that we have to go as far back as 2011 for a comparable 4% sell-off in a single day.

As always, there's a myriad of theories behind the declines, including the proliferation in algorithmic trading and Exchange Traded Funds (ETF's) to blame. The simple matter is stock prices became too high for the prevailing economic conditions, that is stocks adjusted, albeit abruptly, to a revised backdrop for global economic growth and corporate revenues. As the old market axiom goes, the stock market takes the staircase on the way up, and the elevator on the way down.

So there's nothing new in all this, except for the developments coming out of China (a crisis made in China):

- China and the broader Asian region have been the engine room for global growth in recent years, and a slowing Asia has sent the ripples of fear throughout the broader global markets;
- The unthinkable in China, that is, the toppling of Premier Li Keqiang has become a possibility, and hence a source of instability. Li was the architect behind the failed ban on short-selling;
- Global trade has reported consecutive quarters of declines in 2015 (to the end of June) and the biggest slide since the financial crisis. Whereby, merchandise trade comprises about a third of global output. And much like GDP, forecasts for world trade have been scaled back in line with weak levels of industrial production. Due in part to the excess capacity in China and notable currency devaluation.

WORLD MERCHANDISE TRADE, CHART 2



Source: CPB Netherlands Bureau for Economic Policy Analysis

I suspect this affirms the lower and slower backdrop for global growth into the future. More worryingly, if we look back to the economic consequences that followed the market shock back in 2011 (i.e. the year Chinese growth declined from double-digits), we can expect more of the same here:

- The vice like grip on domestic economic growth and squeeze on company earnings to tighten;
- Downturns in markets tend to negatively impact upon business and consumer confidence over future periods;
- Expect small and large businesses retain their laser like focus on costs and staffing numbers;
- Government royalties and wages growth to continue to hover around their lows.

Back to the investors bearing the brunt of falling stock prices and the evaporation of their capital before their eyes, the message is hold tight! Just as there are consequences for indulging in treats like melting moments, there are lasting financial impacts for panic selling (it crystallises paper losses).

The magic of investing lie in the power of *compounding*, whereby the longer the timeframe the bigger the ultimate reward. Afterall, the ASX200 is up over 10% (including dividends) over the last 5 years.

"Never look backwards or you'll fall down the stairs"
~ Rudyard Kipling

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