



# Platform

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Independent Insight in an Uncertain World

# Plexus

Editor:  
Paul Stewart

Tel: (021) 9702400

E-mail:  
info@plexus.co.za

## CAUTION – VOLATILITY INDEX STARTING TO RISE

Global stock markets experienced a precipitous, nerve-racking fall during the first few days of August. This decline was fuelled by a number of poor economic reports, especially the non-farm payrolls data out of the US and global GDP data that are starting to soften. Added to this, speculation levels surrounding the outcome of the European debt crisis shot up amidst the seemingly unending ripples that this evolving story has been sending through the world's equity bourses.

After a decline of 8,9% during the first week of the month, the FTSE/JSE All Share Index made an attempt at a bottom. However, the damage overseas was far more severe, with the MSCI World Index and the MSCI Emerging Markets Index both declining by nearly 14%. European markets suffered the worst declines, however, with the French CAC losing 18,2% and the German DAX 21,6%. All of this happened in the space of only eight trading days!

Investors are currently extremely jittery. At the slightest hint of negative news we see equity markets taking the punch as risk-off trades dominate the market. The latest sell-off left investors a bit shell-shocked to say the least, as some blue chips were among the hardest hit, especially banking stocks. Investors would be hoping that this was indeed the bottom of the fall, but if history is anything to go by, even lower values might still be in the pipeline in a very volatile trading range in the medium term.

Historically these severe sell-offs do not normally correct overnight. Rather, some time is required for market players to digest the avalanche of bad news and of course the possible outcomes. In fact, quite a bit of time might be needed as the Greek default issue is being drawn out by some big European players, especially the ECB. Whilst a Greek default would not be desirable (if not probable), a default in Spain or Italy would have a much more severe effect on the markets.

Plexus is of the opinion that a "calmer" trading environment after the big falls recently may still be some way off though. Unfortunately, for those wanting to get back into the market, the message of the South African Volatility Index (see accompanying graph) is that the market has yet to calm down from August's extraordinary volatility, and may not yet be safe for investors to jump back in. While the South African Volatility Index is a relatively new technical consideration, it is already evident that once it starts hitting the higher levels the equity market is in danger of falling.

The barrage of negative economic data emerging globally and domestically has also put the South African Reserve Bank in two minds about rates going forward. Despite the fact that inflation is edging higher, the market is

now starting to price in a possible rate cut at more than a 50% chance. As we all know, lower interest rates should act as a boost for equities as cash is more freely available for transactions and purchases, effectively boosting the economy, company earnings and share prices. Hopefully this will act as a buffer against possible further downside for the domestic equity market.

So what are investors to do? Conservative investors should stay on the sidelines for now in favour of the safety of cash or fixed-interest assets until the high levels of volatility begin to diminish. However, as history has shown, this could take a number of weeks. Investors who can tolerate risk could follow a more aggressive strategy by averaging their available cash in on any big price declines over this period.

