Prescient
INVESTMENT MANAGEMENT

Surviving volatile market conditions: A Prescient Perspective

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Buckle up, because the market roller coaster just hit turbo mode. The VIX, the market's beloved "fear gauge," has doubled in August, flashing a big, bright warning sign: volatility is back with a vengeance. So, what does this mean for our investments? Should we be hedging our bets, or is it time to embrace the chaos? Let's dive into the Prescient way of navigating these stormy waters.

For the uninitiated, the VIX measures market expectations of near-term volatility. This August, the VIX has shot up 165%, signalling heightened uncertainty. The causes? Geopolitical tensions, inflation fears, and unpredictable central bank moves—a perfect storm rattling investor confidence. The latest bout of market turbulence stems from a disheartening U.S. Department of Labor report on labour data. This report sent shockwaves through global markets, drawing out sellers eager to lock in profits amidst the prevailing uncertainty surrounding the Federal Reserve's stance on interest rates, inflation, and the looming presidential election. But in this chaotic environment lies an opportunity: reinvesting dividends and purchasing additional shares at lower prices.

Globally, technology stocks have led the profit-taking wave. Previously inflated in valuation, these stocks have been significantly oversold. Both the Dow Jones Industrial Average and the NASDAQ have companies with stock prices that far exceed their revenue and profit levels, prompting this phase of profit-taking. The recent jobs report was the worst in over a decade, with U.S. unemployment rising to 4.3% in July, an increase of 350,000 unemployed workers, totalling over 7.2 million. This surge in unemployment has added to the market's jitters. Despite market expectations, the Federal Reserve has not cut rates over the past 18 months due to persistent inflation. The Fed Funds Rate should have been significantly higher to curb inflationary pressures. This has created a delicate rate situation with potential changes on the horizon. Japan is experienced its worst "Black Monday," reflecting the interconnected nature of global markets. This highlights how deeply entwined our economies are, with ripples in one part of the world causing waves in another.

Navigating the complexities of hedging in volatile markets requires a nuanced approach. While hedging can offer protection against losses, it might also limit potential gains during market recoveries. At Prescient Investment Management (PIM), we believe that if your portfolio is heavily invested in equities, hedging can be a valuable tool to mitigate potential losses. For investors who have accumulated significant gains during the bull market, hedging can secure these profits while keeping a foot in the market. For portfolios with high volatility, hedging acts as a stabilising force. Utilizing put options, which allow selling assets at a set price, provides a safeguard against declining prices. Additionally, diversifying investments across various asset classes can help reduce overall portfolio risk.

Despite the current challenges, it's important to recognize that the economy is fundamentally sound, unlike the structural issues we saw during the mortgage crisis of 2008. The Federal Reserve's cautious stance reflects the complexity of today's economic landscape, suggesting that adjustments are on the horizon. Consumer spending remains robust, and earnings continue to exceed expectations, providing a solid foundation for the economy. As recession fears subside and carry dynamics stabilize, there's potential for risk assets to recover. The recent sell-off in U.S. equities, especially in the tech sector, presents compelling buying opportunities. If the Magnificent 7 stocks seemed overpriced in mid-July, their current lower valuations may now offer a more attractive entry point.

Markets have been quick to price in too many Fed rate cuts, highlighting the radical shifts in narrative we've seen over the past 18 months. Credit markets, notably, have fared better than equities, and while we've favoured quality credit for income, we're beginning to see better value emerging in the equity markets. Japan's market reactions go beyond a simple high-beta response to U.S. growth fears; we anticipate that the Bank of Japan will make necessary adjustments. Our overweight position in Japan remains, with drawdowns cushioned by a stronger yen. This episode of volatility carries the clear marks of technical, positioning, and sentiment-driven factors, making it crucial to pay close attention to market flows.

Market resilience is a hallmark of historical rebounds, and we've often seen significant recoveries following periods of volatility. The March 2020 crash and subsequent rally are prime examples of this pattern. Volatility, while unsettling, can present opportunities—sharp market moves can create entry points for undervalued assets. For long-term investors, staying invested through volatility is often more rewarding than attempting to time the market. At PIM, we employ systematic strategies that allow us to dynamically adjust portfolios in response to market conditions, enabling us to capitalize on inefficiencies and manage risk effectively.

Our diversified mix of assets, including equities, bonds, and alternative investments, serves as a buffer against market shocks, and our robust risk management framework ensures that we're not just pursuing returns, but doing so with a mindful approach to potential downsides.

In times of heightened market turbulence, maintaining a steady hand is paramount. It's easy to get swept up in the emotional waves of panic or overconfidence, but such reactions often lead to regrettable decisions. Instead, a calm and measured approach is essential. Diversification, for instance, serves as your portfolio's shock absorber, spreading investments across different asset classes, geographic regions, and sectors to minimize the impact of volatility in any one area. This broad spread not only cushions the blow of a market downturn but also positions you to capture opportunities across various fronts.

Hedging through instruments like options or futures adds another layer of protection, helping to offset potential losses during market upheavals. However, volatility doesn't just create risk—it can also cause your portfolio's asset allocation to drift away from your intended strategy. This is where regular rebalancing comes into play. By trimming positions in overrepresented areas and reallocating to those that are underweighted, you maintain the strategic balance necessary for long-term success.

Setting stop-loss orders or adjusting your asset allocation can be prudent steps to manage exposure, particularly when markets are erratic. Yet, it's equally important to keep your eyes on the horizon. A long-term investment perspective allows you to weather the storms of short-term volatility and reap the benefits of sustained market growth. Staying informed about market trends, economic indicators, and evolving financial landscapes further empowers you to make sound, informed decisions in uncertain times.

Finally, options offer a versatile toolkit for managing risk. Whether you're seeking to protect gains, limit losses, or even capitalize on market movements, options provide a range of strategies tailored to different goals and levels of expertise. In essence, by combining these elements—calm decision-making, diversification, strategic hedging, regular rebalancing, and a long-term outlook—you create a resilient framework that not only withstands volatility but can also turn it to your advantage.

Volatility is a natural part of the market cycle. While the VIX doubling might seem like a cue to run for cover, it's also a signal to stay vigilant and strategic. Whether you choose to hedge or ride the wave, the key is to have a plan. At PIM, we're committed to navigating these turbulent times with a systematic, disciplined approach that aims to protect and grow our clients' assets. So, fellow traders, let's embrace the volatility, make informed decisions, and continue to thrive in these uncertain times. Remember, fortune favours the bold, and in the market, the bold are those who are prepared.

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