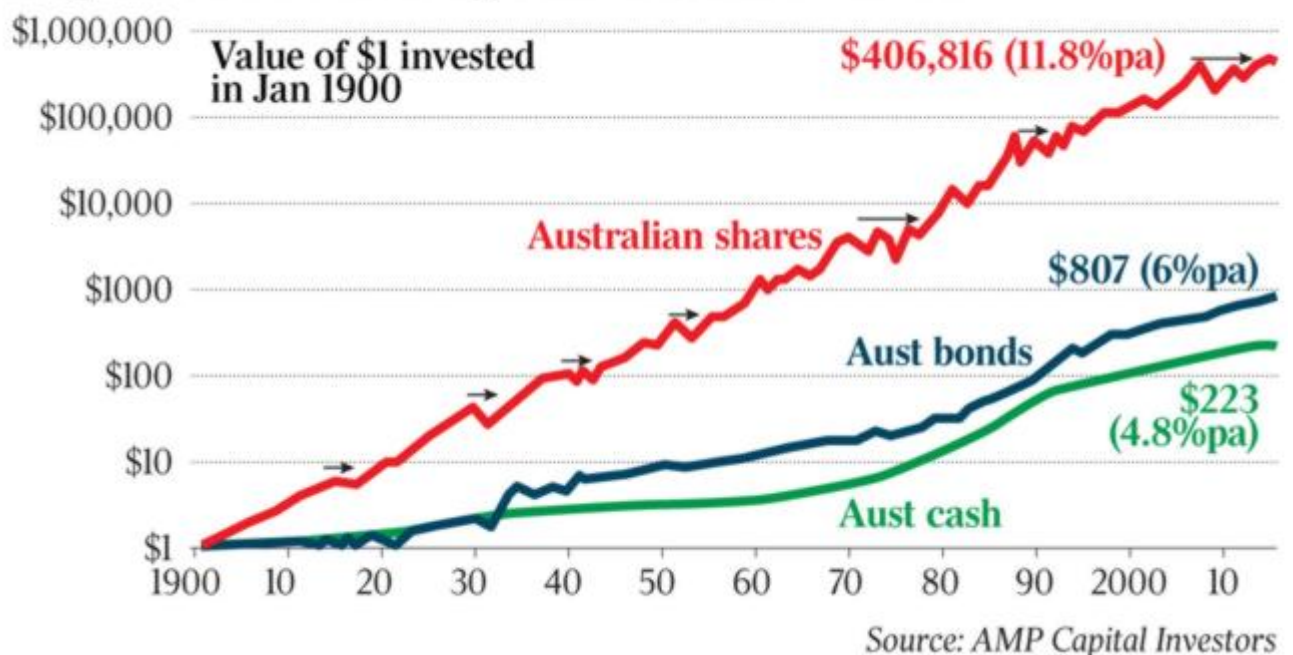


# Five-point plan to cope with market volatility

- [THE AUSTRALIAN](#)
- [SEPTEMBER 29, 2015 12:00AM](#)
- [DON STAMMER](#)

## Keep medium and long term returns in mind



Returns. Source: TheAustralian

**In the past couple of months, sharemarkets have been unusually volatile and generally gloomy. Most market participants I've spoken with recently expect the volatility and nervous times to persist, for the following reasons.**

Investors are understandably concerned with the uncertainties relating to how much the Chinese economy slows and when the US cash rate will be raised. As a result, we're seeing powerful reactions in markets to any disappointing economic data (particularly on business conditions in China) and to major policy statements such as the recent decision by the Fed to leave the cash rate unchanged.

Some investors, among them big hedge funds and high-frequency traders, are taking an extremely short-term view of investment opportunities. Many are trying to profit from the same momentum trades.

Around the world, low returns on cash and a general lack of enthusiasm for spending on real capital are encouraging investors to accept greater financial risk in their hunt for yield. Also, changes in bank regulation have greatly reduced the role of market makers in stabilising the wobbly market conditions.

Here's a five-point plan to help investors cope with volatility and general gloom.

1. Expect investment markets to remain choppy — at least until the US Fed has begun to make the small (and gradual) increases in the US cash rate it's been preparing for and until the depth of the slowdown in China is clearly established.

In the meantime, share investors should avoid the temptation to capitulate on days of extreme gloom — thereby quitting holdings of quality investments at depressed prices. Investors wanting to buy shares at attractive prices might like to average in over several extremely bad days for market sentiment.

2. Investors should remind themselves that things are rarely all black or all white. The current gloom, which seems excessive, will in due course give way to a more balanced and positive view — and to the better rates of return on shares that apply over the medium and long terms.

Certainly, there are some shades of grey in the economic outlook. The US economy has been growing at a moderate rate, a little above 2 per cent, for five years; business capital spending is still subdued, but household wealth and confidence are improving.

Manufacturing in China has weakened but its economy isn't "contracting", as is often reported whenever the purchasing managers' index there comes in below 50 points. Also, average house prices in the main Chinese cities have risen in recent months; the much-feared further collapse in property seems to have been avoided. Europe has avoided the recession and deflation predicted for it early this year.

The Australian economy, too, is doing a little better than was generally expected. The risk of an early recession here has receded, in part because of the responses to the big drop in our exchange rate to the US dollar.

3. Share investors seem overly concerned with how the higher US cash rate, when announced, will impact on sharemarkets.

As mentioned in last week's column, US share prices rose in each of the last four periods when the Fed was raising the cash rate. Moreover, 12 months from now the US cash rate, currently set close to zero, could still be as low as 1.25 or 1.5 per cent. That's higher than is currently anticipated in fixed interest markets but still a skinny rate relative to, say, average US dividend yields, which are around 2 per cent. The Australian cash rate could well be left unchanged at 2 per cent through to early 2017.

4. These are the times when quality stocks, with good earnings and paying secure dividends, can become attractively priced for investors prepared to be patient and to go against the prevailing sentiment in investment markets.

5. The recent volatility has been much greater for shares than for bonds. My guess is we should expect bond markets to become more volatile in coming months as the Fed moves its cash rate higher. Volatility in bonds is particularly likely to soar if bond investors lose their abundant confidence in sustained disinflation; currently, the pricing of US bonds implies a decade of inflation averaging 1.6 per cent a year.

*Don Stammer chairs QV Equities, is a director of IPE, and is an adviser to the Third Link Growth Fund and Altius Asset Management. The views expressed are his alone.*