PREPARED BY DANE JANSEN, CHIEF INVESTMENT OFFICER

What is happening in markets and what you should do now?

Another year that seems to be flying by and as we get closer to the end of the year, financial markets appear to be going through a fit of irrationality. Investors would be wise to steer clear of letting an unpredictable market dictate their next move, in or out of markets.

We don't often concern ourselves over short-term market movements. Over the years, most days the market goes up or down some fraction of a percent which is followed by commentators making up some reason to explain it. In more recent times it can be up and down a couple of a percent in a day. We are told the market dropped 1% because of "profit taking" and go back to whatever it is that we were doing.

However, the last couple of weeks have been a bit more dramatic. And this is where market movements can really impact investing. Investing is the process that we all go through to take our savings and grow them to achieve a goal. And consistency and patience are key drivers of results.

So, what is happening in markets?

In a nutshell, equity markets sold off sharply due to a number of factors raising their heads at the same time, and bond markets rallied off the fears that spooked the markets.

A brief overview of what has actually happened provides a backdrop for the challenges we are facing. From escalating conflicts around the globe with clear alliances forming, the hype wearing off AI (artificial intelligence), to cheap money become less cheap.

The turmoil began in the **USA**. Following the S&P 500's stellar double digit returns since the start of the year the market has become sceptical around the ability of large tech companies (that have delivered the majority of performance for the S&P) to monetise AI off the back of earnings from the tech giants. Then further pressure was added with the jobs report showing weakening conditions which set off the panic alarm that the US economy was headed for a recession.

The Nasdaq was hit harder than the S&P crossing into correction territory with over 10% drop from recent highs. Over $1 trillion US was shaved off the market caps of the magnificent seven.

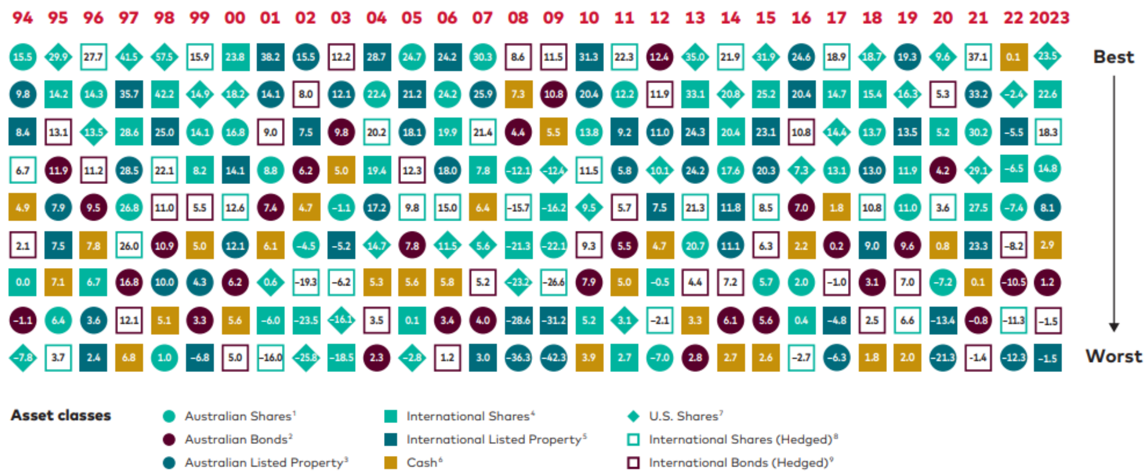
This newsletter is intended only for clients of Positive Dynamics Pty Ltd. and the content of this newsletter does not constitute specific financial advice.

To **Japan** who were also displaying all time market highs bolstered by the strength of their economy, but Nikkei plunged 12.40% in a day, this was the biggest 1 day drop Japan had seen since 1987. The index fell off for the past month overall by 25%, before making in a spectacular bounce of 11%+ last week. All of this hysteria was a culmination of a surprise rate hike by 0.25% for the first time in 17 years which ended years of negative interest rate cycle and what is called reversal of a carry trade (borrowing cheaply in low rate countries to invest in high rate markets), the low rates in Japan had made the yen a funding currency for investments in many of the markets, however the unexpected rate rise in Japan and the softening of the US economy and mega caps essentially created a margin call as more money was required to flow back to Japanese banks. The initial knee jerk reaction was tempered later in the week as mentioned but markets are likely to remain on edge, nonetheless.

In **Australia** the ASX 200 dropped nearly 6% from its all-time highs.

There is rhyme and reason for all of what we have been seeing and it's definitely not the first time we have seen violent volatility. In 2022 the S&P 500 'corrected' which is a drop of 10% or more four times. In 2023 there was one market correction. Since 1980 the S&P 500 has averaged a drop 4.5 times a year of 5%-10%. It happened 12 times in 2022 and 3 times in 2023. The drop in valuations creates very encouraging buying opportunity for those able to stomach the volatility

While not trying to play down what we are seeing or what you may be feeling because there are some factors that raise concern, but a bit of context is always helpful. These drops in the market happen all the time and as mentioned above consistency and patience are key drivers of investment results and we don't want to go jumping in and out willy nilly. **That said we don't know what the future has in store and market sentiment can switch quickly and this is exactly why we hold bonds and alternative assets, and why a diversified portfolio is crucial for building long term wealth.**



This newsletter is intended only for clients of Positive Dynamics Pty Ltd. and the content of this newsletter does not constitute specific financial advice.

There are definitely opportunities to be had in all areas of the markets particularly now that equity prices have pulled back so far as to provide an entry price into most markets only a few percent higher than in January this year, but there is another less obvious opportunity our portfolios are prepared for. The increase in the value of Bonds/fixed interest; Most bonds pay a fixed interest rate, so existing bonds become more attractive if interest rates fall, driving up demand for the bonds with the higher interest rate and increasing their market value.

As legendary investor Ray Dalio says **diversification is about finding a balance**. It's not just diversifying across different asset classes, but also within them. This means not only investing in stocks and bonds but also considering different industries, geographies, and even investment styles. **The idea is to create a portfolio where the performance of one asset offsets the underperformance of another, reducing overall volatility and risk**. Our portfolios have been specifically tailored with just this in mind, hence the minimised volatility and pull back our portfolios have recently experienced compared to their benchmarks.

Our observation of the current market movement is that it is a 'black swan' event as a result of many different economic and geopolitical occurrences within a short period of time, as we saw in the GFC a 'black swan' can be catastrophic. It obviously gives poise to keep our heads on a swivel and take in what is going on around us, but it is certainly no reason to panic. Everyone understands (economically) things aren't great but were not sure they are that bad either.

U.S. economic data indicates we probably won't see a recession this year which means that the Fed may have navigated its path to a soft-landing. Most experts think the reaction to the weaker-than-expected jobs number was blown out of proportion due to the external noise around. Australian employment data looks robust, and the property market looks strong with demand outpacing supply.

It's anticipated that further investment into smaller companies will prove positive as they are expected to benefit from lower funding costs, as the broader small cap sector is highly exposed to variable rate loans. Historically, when the stock market has seen outsized gains from a select few companies, this has been followed by rotation in companies and sectors that were unloved during this period.

Finally, expected rate cuts domestically and globally have historically favoured sectors like infrastructure and real estate investment trust (REITs). As the Fed leads the interest rate cuts the U.S dollar is likely to weaken compared to other currencies, and a weekend USD has generally favoured safe-haven assets like Gold. Treasury bonds have also historically performed well during periods of rate cut which as mentioned is something we are positioning back into our portfolio.

In closing, our ideas at Positive Dynamics are simple. Stick to the investment strategy. Control what we can control. Make sure asset allocations remains appropriate to the client. And invest in regions, managers, sectors and asset classes we believe in.

This newsletter is intended only for clients of Positive Dynamics Pty Ltd. and the content of this newsletter does not constitute specific financial advice.