

Market Insight from our UK investment management partner TAM Asset Management



The Fed and Tokyo: Correction or Contagion?

After a strong rally since the start of the year, the first week of August saw a deeply negative period for developed markets. The belief that the Federal Reserve would be able to gracefully start its descent from the fastest increase in interest rates in four decades was looking unlikely. This rosy scenario had fuelled an impressive rally in US assets.

The reality seems that the US economy is slowing, signalled on Friday by a soft jobs report (fewer hires, more people off-work and more lay-offs than expected). This data, on the back of results from semiconductor companies which fell short of investors lofty expectations, placed the tech heavy Nasdaq firmly in correction territory (a 10% fall from June 10 high).

Not just tech but there were other corners of the market, even consumer stalwarts such as McDonald's which saw disappointing earnings. Investors are now betting on a 0.5% reduction in rates in September, with many economists believing the Federal Reserve are now possibly 'behind the curve' as a potential recession is discussed.

This round of short-term fear was driven higher by Japanese stock market reaction. On Monday, western investors woke up to the Japanese index, the 'Topix' seeing its sharpest sell off since Black Monday, 1987. This was coupled with a similarly aggressive selloff on Friday totalling a combined 20% drop from a July peak. The market was beset with "circuit breaker stops" – a stop trading mechanism designed to control panic.

TAM sold its single Japanese equity fund in the Active portfolios in May after identifying what we deemed better opportunities in other equities. Therefore, we have been isolated from the chaotic moves in Japanese equity markets for the most part.

The contagion into the US and Global markets was not however unexpected. In terms of the fall in US equities and despite our long-term optimism on some productivity gains surrounding artificial intelligence, certain corners of this trade have become very stretched in the near-term. Nvidia, the darling of AI, is seeing incredible levels of daily fluctuations in price after an impressive rally.

Overnight, we saw Asian markets lead a rebound with the Japanese Topix index returning 9.3%, with the more tech-concentrated Nikkei index surging to its biggest intraday win in history. However, this was not enough to recover the losses of the day before. Further, we remain increasingly aware that these are historic levels of intraday volatility which are not tantamount to normalcy in developed markets. After months on the sidelines, volatility is well and truly back.

As a result, we have increased the position in a fund which benefits from these swings in equity prices and the protection investors seek as a result, as well as adding to existing government debt funds which retain a safe haven label they have earned in previous bouts of outsized market moves.

Corrections in markets can often be healthy and clear out some of the overexuberance that bull markets are so often intertwined with. Contagion on the other hand can lead to short term panic and potential longer-term damage to asset valuations. We anticipate continued volatility in the short term but remain confident in the long-term narrative of diversified growth and whilst we are presently embroiled in a period of higher volatility, this will give opportunity in assets unfairly distressed by broad market sell offs.

If you would like to speak with TAM Europe about anything in this note, or to discuss our discretionary investment management services in general, please get in touch with our European CEO Lester Petch today.