# ***Recent Market Volatility***

With US equity markets suffering their worst week in over four years, it raises the question of what caused this volatility and what to do about it. Our response in a nutshell, is to ***avoid a knee jerk reaction*** to heightened market volatility and to remind our clients that your portfolios are ***broadly diversified.*** We continue to scour the world to add value and are starting to see some opportunities – which could augur well for the longer term.

August is supposed to be the month where most of the world goes on vacation with halcyon days and lazy sunsets. On August 11, the Peoples Bank of China (their Federal Reserve equivalent) allowed the Chinese Renminbi Yuan (***RMB) to fall by almost 2.0%*** in a move that caught most market participants by surprise. While small, this move has been variously interpreted as an act of ***desperation*** by Chinese authorities to boost economic growth at the cost of other industrialized countries exports.

A growth slowdown in China is not a surprise: Indeed, we have felt for over a year now that ***real Chinese growth was closer to 4.0 to 4.5%*** rather than the published GDP (target) figure of 7.0%. The Chinese economy is in the process of making a ***difficult transition*** from an export driven, infrastructure intensive economy to one driven primarily by domestic consumption. This transition often takes years if not decades to accomplish and there are bound to be disruptions as a result of this.

What is worrying, however, is a related ***precipitous decline in Chinese equities*** (which had witnessed outsized gains earlier in the year amidst worries about a "stock market bubble") and a series of declines in other emerging market currencies (like the Vietnamese Dong and the Brazilian Real) in order for those countries to stay competitive relative to the value of the RMB – echoes of the Asian currency crisis from 1997/98, if you will.

As many of you are aware, your portfolios have had very limited exposure to ***emerging markets*** over the past few years given our worries about valuations in this sector. If the sell-off there were to intensify and valuations become more appealing, we would certainly be ***interested in gaining exposure*** to this sector over the next few months and quarters.

Adding to the volatility are also sharp declines in the prices of ***many commodities*** like crude oil (as a result of excess supply), copper and other industrial metals (due to fears of slowing global growth). Despite its ***challenging impact locally*** (after all Houston is the center of global energy markets), falling crude oil prices do, at the margin, represent a tailwind for consumers (they can spend money on things other than just gasoline) and businesses (where profit margins widen with cheaper energy).

With many experts calling for crude oil prices to decline further (perhaps into the $20-$25 per barrel level), we are watchful for opportunities here as well – where ***price movements*** tend to be ***quite irrational.*** The underlying cyclicality of the industry makes it much more amenable to contrarian plays from an investment perspective.

The Federal Reserve is poised to raise interest rates for the first time in nine years next month: This is a move that has been widely telegraphed and will likely still happen despite the volatility in equity markets. Having said that, we do expect the trajectory of rate hikes to be ***shallow*** and the ultimate ***terminal rate*** to be much lower than previous cycles. In fact, recent volatility has caused longer end interest rates to decline, and a flattening of the yield curve.

US economic data have been, on balance, positive: ***Housing*** (as a result of greater household formation) and ***automobile sales*** (as a result of an aging fleet of motor vehicles currently on the road) have continued to post upside surprises and the labor market appears to be well on its way to healing, slowly but surely.

In summary, the market correction is providing an opportunity for a thoughtful rebalancing of portfolios to take advantage of a change in relative values, despite the ***painful nature of a short term correction.*** Please do not hesitate to contact us if you would like to discuss this or any other issues in more detail.