On The Mark

August 15, 2019

What's driving market volatility?

Key Takeaways

- The S&P 500 is off its high on heightened trade tensions, a lower than expected Fed rate cut, and a series of negative headlines in August.
- Bonds have posted strong returns this year as negative-yielding debt balloons to $15 trillion.
- Despite escalation, the U.S. remains relatively insulated from global trade. Investors should brace themselves for lower market returns, elevated volatility and remain disciplined relative to their long-term goals.

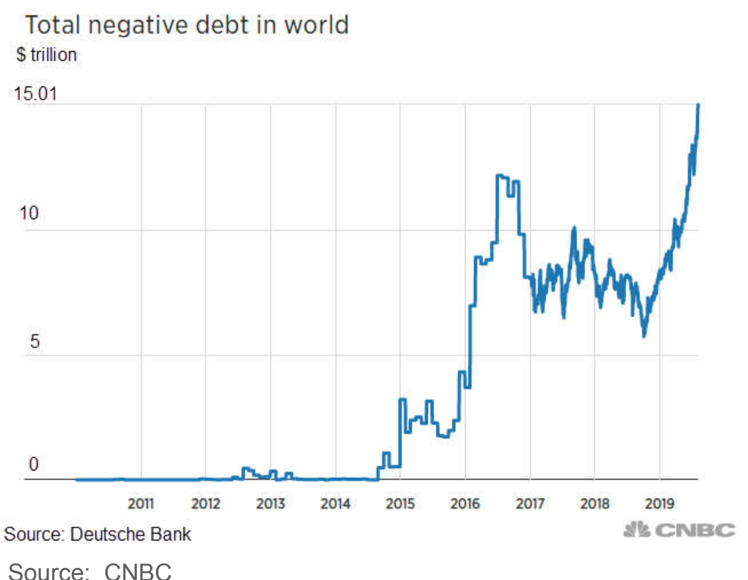
Why are stocks falling in August?

August has been a rollercoaster month for stock markets. It began with the Fed disappointing the markets with an interest rate cut that was lower than anticipated. Thereafter, the sell-off accelerated when the White House announced that a 10% tariff on the remaining $300 billion of Chinese imports will go into effect on September 1st. This set off a response from China letting its currency fall through an important exchange rate threshold to help make their exports cheaper, while at the same time announcing a buyer's strike on American agriculture. The U.S. responded by labeling China as a currency manipulator. To top off the list of concerns, the U.K.'s grind toward a potential no-deal Brexit and the worries of a slowing global economy all led global markets lower from prior highs. Just as tensions were high, stocks surged after the U.S. said it was delaying some China tariffs until December 15th. Despite the numerous negative headlines, the S&P 500 has shown some resilience and is off about -3.3% from its record highs as of August 13th.

What about bonds?

As market volatility continues, demand for safe haven assets continued to push bond prices higher and correspondingly pull bond yields lower. Bond yields move in the opposite direction of prices. Yields fall when investors demand bonds. The demand for US bonds has not only been driven by slower global growth and the escalation in trade war, but also due to an increasingly growing share of negative-yielding global debt. A negative yield bond means an investor who buys the bond will receive less money at maturity than the initial amount invested. This is far from how bonds normally work. Historically, people give the government their money with the promise of being paid back with interest. Now, governments are essentially getting paid to borrow money.

So why on earth would anyone sign up to lose money? Global economic uncertainty has investors so fearful of the future that they prefer a small loss on government bonds to a much bigger loss elsewhere. In addition, entities such



Source: CNBC

as global central banks and insurance companies need, or have, a regulatory requirement to hold bonds as part of their reserves, thus continuing to drive up demand.

Therefore, government bonds that trade at negative rates have ballooned to about $15 trillion, an amount that's nearly doubled since the end of last year according to Deutsche Bank.

All negative yield bonds can be found outside of the U.S., as shown in the matrix below, as of August 5th. For example, investors who buy and hold a 10-year German Bund to maturity are now guaranteed to lose -0.52% of their money.

@CharlieBilello	The Negative Bond Yield Matrix													
Country	1-Year	2-Year	3-Year	4-Year	5-Year	6-Year	7-Year	8-Year	9-Year	10-Year	15-Year	20-Year	30-Year	50-Year
Switzerland	-0.71	-1.04	-1.05	-1.05	-1.03	-0.98	-0.92	-0.89	-0.95	-0.87	-0.61	-0.49	-0.31	-0.19
Germany	-0.73	-0.81	-0.84	-0.82	-0.78	-0.75	-0.71	-0.66	-0.63	-0.52	-0.36	-0.22	-0.02	
Netherlands		-0.78	-0.79	-0.78	-0.71	-0.64	-0.59	-0.52	-0.48	-0.40	-0.26	-0.16	-0.01	
Denmark		-0.83	-0.78		-0.73			-0.62		-0.48		-0.26		
Japan	-0.19	-0.21	-0.24	-0.26	-0.27	-0.28	-0.28	-0.26	-0.22	-0.19	0.00	0.15	0.29	
Austria	-0.61	-0.75	-0.69	-0.69	-0.61	-0.56	-0.48	-0.44	-0.38	-0.29	-0.03	0.10	0.34	0.49
Finland		-0.73	-0.72	-0.70	-0.65	-0.60		-0.40		-0.26	-0.05		0.21	
Sweden		-0.62			-0.64		-0.45			-0.22	-0.05	0.23		
France	-0.62	-0.71	-0.75	-0.72	-0.64	-0.57	-0.49	-0.41	-0.33	-0.24	-0.07	0.29	0.62	0.81
Belgium	-0.63	-0.63	-0.73	-0.70	-0.64	-0.56	-0.42	-0.34	-0.30	-0.18	-0.05	0.32		
Slovakia	-0.39				-0.36	-0.63		-0.17	-0.08	-0.13			0.69	1.01
Ireland	-0.56		-0.52	-0.50	-0.43	-0.33	-0.24		-0.09	-0.01	0.36	0.55	0.91	
Slovenia	-0.07	-0.30	-0.51		-0.35		-0.24	-0.17		-0.03		0.70		
Spain	-0.49	-0.50	-0.48	-0.40	-0.26	-0.20	-0.08	-0.02	0.09	0.24	0.66	0.67	1.14	
Portugal	-0.40	-0.54	-0.38	-0.29	-0.23	-0.09	-0.02	0.08	0.19	0.28	0.66	0.84	1.18	
Malta	-0.29		-0.25		-0.25					0.30		0.91		
Cyprus	-0.07		-0.04		0.08		0.28			0.50				
Italy	-0.15	-0.04	0.33	0.57	0.85	0.99	1.11	1.26	1.30	1.54	2.06	2.24	2.59	2.80
Bulgaria	-0.20		0.30		0.18		0.37			0.45				
United States	1.76	1.60	1.56		1.56		1.65			1.76			2.31	

Source: Charlie Bilello

This dynamic of negative interest rates abroad has driven foreign demand for US Treasuries further compounding the decline in US yields. All of this has translated to strong returns in bonds. The Bloomberg Barclays U.S. Aggregate Bond index, the benchmark for most bond index funds, has generated 8.0% year to date through August 13th. In fact, the longest-maturity government bonds have led the rally this year. A popular longer-term US Treasury ETF has generated nearly 19% year to date slightly outperforming S&P 500 returns of 18.2% for the year.

What does this mean for investors?

First, despite the volatility in stocks, research from City National Rochdale shows the US economy is relatively insulated from global trade. The research report stated: "Exports make up only about 12% of the US GDP, and trade with China specifically accounts for only 1%." The report estimated the impact from current and potential tariffs will shave only about 0.35% off US growth. Overall, the fundamentals of the economy remain steady with low unemployment, a strong consumer base, and a supportive Fed. Second, it's important to have some perspective on market volatility. Market volatility is never fun, but it is normal and an inevitable part of long-term investing. According to research by Capital Group, declines for the S&P 500 index of -5-9% happen about three times a year, while a decline of -10% or more happens about once a year.

Finally, predicting interest rate moves and/or calling year-end stock targets is notoriously difficult. Just as rates have fallen this year, we could also see longer-term bond rates rise slightly if the Fed cuts rates later this year. The move by the Fed would alleviate concerns of a recession and could cause demand for bonds to fall thus leading to lower bond prices. In a low to negative yield environment, it requires investors to remain disciplined, flexible and open-minded and not rush into investments solely based on their performance to date.

AssetMark, Inc.

1655 Grant Street
10th Floor
Concord, CA 94520-2445
800-664-5345

IMPORTANT INFORMATION

This report is for informational purposes only, and is not a solicitation, and should not be considered as investment or tax advice. The information has been drawn from sources believed to be reliable, but its accuracy is not guaranteed, and is subject to change.

Investing involves risk, including the possible loss of principal. Past performance does not guarantee future results. Asset allocation alone cannot eliminate the risk of fluctuating prices and uncertain returns. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. No investment strategy, such as asset allocation, can guarantee a profit or protect against a loss. Actual client results will vary based on investment selection, timing, and market conditions. It is not possible to invest directly in an index.

AssetMark, Inc. is an investment adviser registered with the Securities and Exchange Commission.
©2019 AssetMark, Inc. All rights reserved.

31404 | C19-0163 | 08/2019 | EXP 08/31/20