



AlternativChronicle

Anatomy of Panic in the Equity Markets



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ASI — What we do:

Alternativ Solution Inc. (ASI) offers consulting services on capital markets to institutional clients. We deal in topics ranging from investment strategy, risk management, asset allocation, manager selection and manager assessment.

Our recent engagements include development of investment policy, searches for money managers, investment strategy (active vs. passive), and alternatives such as infrastructure, real estate and smart beta.

ASI also offers Trustees and Board members with financial education or training.

Mr. Klar is a faculty member in the Finance area at the Schulich School of Business and is a senior advisor to York University's \$2.1 billion pension plan.

....Cheers, GMK

Ouch! Such pain! We just had one of the worst January starts for US equity markets. The S&P500 plunged 9.00% in the first 20 days. By month-end, a rebound lifted the index to just a 5% loss.

This decline was mirrored in other stock exchanges. China's Shanghai Stock Exchange composite index fell 22.7%, Japan's Nikkei 225 fell 8% and the MSCI European Index lost 6.8%.

Why are equity prices falling? Pundits offer many explanations, but they boil down to one thing: economic and political worries are happening at the same time.

The Middle East is a continuing source of tension. In Syria, the Civil War has cost thousands of lives and displaced millions. The fighting has been raging for years. Millions of people are dispersed causing a large influx of refugees to Europe. This is generating a major social and political backlash.

Radical Islam is expanding geographically. ISIS has already perpetrated acts of terror in major cities like Paris and they promise more. Clearly, this is unwelcome and worrisome.

Powerful nations are vying to protect themselves while maintaining an advantage over other states. USA, Russia, China, Europe, UK, Germany, Iran, Saudi Arabia

(and others) are using proxy agents, mini-wars, electronic surveillance and whatever means necessary to achieve their goals. This is no surprise given the nuclear ambitions of some countries.

On the ground, there is wide-spread mistrust or disillusionment. Corruption and mismanagement are endemic in many parts of the world.

This is exacerbated by authoritarian leaders whose decisions and interests conflict with the citizenry. It creates a breeding ground for violent rebellion as the only way to make meaningful change.

In democracies, elected officials seem powerless to cope with our rapidly changing world. In the US, the process of selecting the next President has begun. The race has very high stakes but so far seems more about theatrics than real leadership.

Economically, despite the actions by central bankers since 2008, global economic growth is still weak. Commodity prices have dropped as a result. The 70% price drop in oil due to oversupply is creating a lot of disruptions. Even so, environmentalists warn of dire climate consequences unless we ween ourselves off fossil fuel.

China, the world's 2nd largest economy, is slowing. Authorities are trying to stabilize this via foreign exchange devaluations.

Given our global interconnectedness, problems in one area quickly flow into others. In this light, It's hard to be optimistic. No wonder there is nervousness, a lack of faith, and infectious negativity. Stock markets are merely reflecting these sentiments.

Lastly, equity markets have morphed into speculative trading places instead of a means to invest in our future. Too many "investors" treat equity markets as casinos. Why bother travelling to Las Vegas where the odds of winning are below 50%, when equities can earn higher returns and have minimal access costs.

In my opinion, we are witnessing large scale negativity coupled with rampant speculation. This creates a flow of funds problem. Investors are dumping stocks in a rush for the exits, regardless of the firms' true worth. Cash levels are rising fast.

The end game will come when piles of cash sits idle on the sidelines or when negativity dissipates.

The pendulum today has shifted too far into fearful territory. If history is a guide, this will reverse. Only the timing is unknown. ■

