



## CIO Flash

### Global market volatility: more to come, but opportunities too

August 24, 2015

+++ CIO FLASH +++ CIO FLASH

#### A severe summer storm

- In recent days, markets have taken fright, ostensibly due to fears over Chinese growth. There have been sharp drops in developed-market as well as emerging-market (EM) equity indices, along with commodity prices. The situation has been worsened by the holiday season, reducing liquidity and turning a manageable correction into a real summer storm.
- China is the "swing state" in this shift to "risk-off" sentiment, with markets focusing most recently on poor manufacturing data. (Export data has also disappointed.) Our base-case scenario remains for a soft landing for the Chinese economy, although with uneven data quality and many structural changes underway, it is difficult to make an accurate assessment of the country's economic health.
- Emerging markets have suffered from China's woes, but we believe that this is not a repetition of the 1997-Asian crisis. Focus instead on three of the four BRICs (Brazil, Russia, China but not India) and selected others, e.g. Turkey and Thailand. Emerging markets facing domestic political problems and/or with high U.S. dollar-denominated debt burdens may be most at risk.
- The impact of recent events on the developed markets has so far not been primarily through trade (the traditional linkage) but through developed-market corporates with high emerging-markets exposure.
- We continue to believe that the U.S. Federal Reserve (Fed) will raise rates in 2015, either in September or December. Postponement of a rate hike might give some short-term relief but there is a greater risk that markets will see it as a sign that things are going wrong with the global economy. Fed wording and guidance will be very important.

#### Several more days of rain

We have long warned about the dangers of "flash crashes" and predicted at the start of the year that volatility was likely throughout 2015. We believe that the market correction could go on for several more days. Severe market moves have already triggered stop-loss type provisions, forcing some funds to sell holdings. But markets will take reassurance from further strong U.S. or European data, although any improvement in Chinese data may initially be met with some skepticism. Chinese structural reforms will take time to have results but changes to Chinese monetary policy (e.g. cuts in the reserve requirements ratio) could have symbolic importance. As noted above, Fed communication is likely to be important.

- **Equities:** We believe it is likely that the immediate market reaction has been overdone and that there will be some selective buying opportunities, although the complexity of the situation makes it difficult to predict a market bottom. Valuation levels for European equities have become attractive again in our view; a renewed appreciation of the U.S. dollar would be a positive for Eurozone companies. We remain on the sidelines with regards to EM equities, as this is the market segment that will probably see the most cuts to earnings estimates in the coming weeks.
- **Fixed Income:** Again, markets appear to have overreacted in some instances and our current view is to tactically underweight 10-year Bunds. On Eurozone periphery, we stay neutral. With regards EM sovereigns, we would stay on the sidelines for now; there will be opportunities, but liquidity in the market is currently thin. We are underweight on EM credit as a whole due to the large weights of certain markets, but this asset class needs to be considered on a sectoral or country basis, rather than by region. We stay neutral on developed-market investment-grade and high-yield debt.
- **Commodities:** The slump in the oil price is bad for sentiment but, given that it is more of a supply issue than a demand issue, it does not necessarily reflect poor gross-domestic-product (GDP) growth. The positive impact on consumers remains important, in our view.
- **FX:** The euro's role as a funding currency means that it is likely to do well during periods of "risk-off" market sentiment. However, as the situation stabilizes, we expect the long-term trend of U.S. dollar appreciation to resume.

**Bottom line:** Expect further volatility, but the summer storm will pass.

Investments are subject to various risks, including market fluctuations, regulatory change, counterparty risk, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you may not recover the amount originally invested at any point in time.

Deutsche AWM expectations 2015. Forecasts are based on assumptions, estimates, opinions and hypothetical models or analysis which may prove to be incorrect. No assurance can be given that any forecast or target will be achieved; Deutsche AWM Investment GmbH, CIO Office; Deutsche Bank AG; As of August 24, 2015



CIO Flash – Global market volatility: more to come, but opportunities too – Aug 24th, 2015