Harvest
Sow, nourish & harvest your wealth

MARKET UPDATE

26 August 2015

Market corrections - a necessary pain

Share markets around the world have fallen sharply over the last week. A number of events including a revaluation of the Chinese currency, weak Chinese manufacturing results and the expectation that the US will raise interest rates sooner rather than later, have combined to produce one of the largest share market falls that we have experienced since the Global Financial Crisis.

However, we do not see this as being the start of a prolonged period of market falls, we see this as being a discrete correction within an otherwise ongoing period of long term positive share market returns. Although they can be tough to bear at the time, corrections which are intermittently spread throughout periods of long term positive share market performance are actually a healthy thing because they help to return value to sharemarkets and ensure that they can to continue its upward trend.

All eyes on China

A large sell off in commodity prices and Chinese stocks is one of the primary drivers of the recent sharemarket fall. It is a manifestation of investor concern that Chinese GDP growth will slow even faster than expected and will drag down global economic growth with it. These concerns have caused China's main stockmarket to lose just over A$1.4 trillion value in the last four days of trading.

The People's Bank of China (PBOC) acted to ease these concerns overnight by announcing a range measure to further ease credit and increase liquidity within China's banking sector. The PBOC cut their headline interest rates by 0.25% overnight (the 1 year deposit rate will be cut from 2.0% to 1.75% and the 1 year benchmark lending rate will be cut from 4.85% to 4.6%). In addition, the PBOC will also reduce bank's reserve requirements by 0.5% effective from 6 September 2015.

The PBOC hope that increasing liquidity and easing credit will encourage Chinese lenders to provide increased finance to support employment growth and boost productivity.

Conclusion - what to expect in the near future

In most cases, markets will rally strongly in the weeks following a significant drop such as this. Indeed, research from Shaw and Partners shows that equity markets have a 74% chance of being up in the 12 weeks following a fall on a similar scale (see table at the top of the next page). In the remainder of cases, a more significant event was taking place (such as the GFC) which caused markets to continue to fall for a longer period of time.

S&P 500 weekly drops of 5% or more since 1980

Date	One Week %	Next Week %	Next 4 Weeks %	Next 12 Weeks %
07/03/1980	-5.95	-1.38	-4.44	4.06
12/09/1986	-7.91	0.67	2.09	8.89
09/10/1987	-5.18	-9.12	-19.50	-20.57
16/10/1987	-9.12	-12.20	-13.11	-13.90
23/10/1987	-12.20	1.44	-2.51	1.54
04/12/1987	-6.83	5.09	10.34	17.21
13/10/1989	-7.01	4.06	1.64	5.57
28/08/1998	-5.00	-5.18	1.71	13.28
04/09/1998	-5.18	3.61	2.95	22.43
15/10/1999	-6.63	4.35	11.92	15.50
28/01/2000	-5.63	4.72	-1.97	5.47
14/04/2000	-10.54	5.75	4.75	9.02
16/03/2001	-6.72	-0.93	2.87	9.95
21/09/2001	-11.60	7.78	11.15	16.29
12/07/2002	-6.84	-7.99	-1.38	-13.11
19/07/2002	-7.99	0.60	9.56	-1.47
18/01/2008	-5.41	0.41	1.87	0.58
03/10/2008	-9.38	-18.20	-11.87	-20.60
1/10/2008	18.20	4.60	3.53	3.62
24/10/2008	-6.78	10.49	-8.75	-3.04
14/11/2008	-6.20	-8.39	0.74	-0.54
21/11/2008	-8.39	12.03	10.98	3.35
20/02/2009	-6.87	-4.54	-0.20	14.65
06/03/2009	-7.03	10.71	23.28	34.50
07/05/2010	-6.39	2.23	-4.14	-0.84
02/07/2010	-5.03	5.42	7.73	12.33
05/08/2011	-7.19	-1.72	-2.12	7.15
23/09/2011	-6.54	-0.44	8.96	7.32
21/08/2015	-5.69	-	-	-

Source: Shaw and Partners

We expect that volatility will continue, however, we are optimistic that the market will return to normal in the near future. Indeed, the Australian market had a positive day yesterday (up +2.7%).

Europe also bounced back with share markets in Germany (+5.0%), France (+4.1%) and the UK (+3.1%) all making substantial positive gains overnight.

Contact us www.harvestgroup.com.au | (02) 8908 4300 Follow us

Harvest