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Stock Market Volatility - The New Normal

What is the issue?

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- Various other global and national economic parameters are expected to cause market uncertainties and usher in monetary tightening.
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- Consequently, stocks may experience more volatility for the foreseeable future.
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What are the current market trends?

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- The Sensex advanced about 28% and the Nifty climbed 30% in 2017, which slated a record bull run.
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- Also, 2018 saw a strong start but since the beginning of February, stock markets around the world have witnessed a sharp correction.
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- The U.S.'s decision to impose import tariffs on steel and aluminium was the latest development to infuse a sense of uncertainty.
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- While the poor state of health of public sector banks has added to the pain, a more broad-based decline in the markets is palpable.
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- Presently, Sensex and Nifty are marginally down from the initial 2018 levels.
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- Hence, Investors who expected 2018 to be yet another blockbuster year for stocks may have to temper their expectations.
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Why is volatility expected to reign?

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- After the sharp correction in February, many expected Indian stocks to rebound to new highs, as in the case of previous corrections.
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- But the Nifty and the Sensex, which largely remained flat till recently after the February fall has now resumed their downtrend.
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- While it is not clear on whether this will continue or a consolidation will take place soon, investors seem willing to take risks and bet high on Indian stocks.
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- This belies reason as there are fundamental weaknesses like – plummeting corporate earnings, underperforming economy.
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- Hence, considering the irrational optimism despite the underlying risks, it's only natural that stock prices will tend to oscillate and remain volatile.
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What are the challenges?

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- The biggest challenge ahead for stock prices will be higher interest rates as central bankers move to rein in inflation as growth picks up elsewhere.
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- The U.S. Federal Reserve is expected to reduce the size of its balance sheet by $2 trillion in the next four years as it moves to let interest rates rise.
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- Bond yields have begun to reflect the prospect of tighter liquidity and the U.S. 10-year Treasury has almost approached the 3% mark (from 2% 6 months ago)
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- Many noted bond investors have confidently proclaimed the end of the multi-decade bull market in bonds, which began in the early 1980s.
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- Indian bond market too witnessed a sharp increase in yields recently, amid fears of faster inflation and government's worsening finances.
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- Stocks markets have thus far shown minimal reaction the prospect of higher interest rates (lesser liquidity).

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- But higher interest rates are likely to eventually dampen stock prices, although it will continue to remain volatile.

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Source: The Hindu

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