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InvesTips

Navigating volatility

WS Global Chief Investment Office

June 2024

As we entered 2024, investors were still nervous that the US economy would head into recession. While you might not realise, global equities chalked up the best first quarter return (up nearly 8%) over the last 5 years this year.

This performance was particularly impressive, given it came against the economic backdrop of upside surprises to inflation which reignited the "higher for longer" inflation and interest rate fears, pushing the 10-year US government bond yield significantly higher.

The markets turned less calm since the second quarter of 2024, on the back of a series of retaliatory responses between Iran and Israel in the first three weeks of April. WTI crude oil prices soared past $85/ barrel. Equity volatility spiked by 50% at one point from near-historical low levels, triggering a 5% drawdown in US equities during the period.

However, since then, global equities have once again rallied strongly, pushing us to all-time highs.

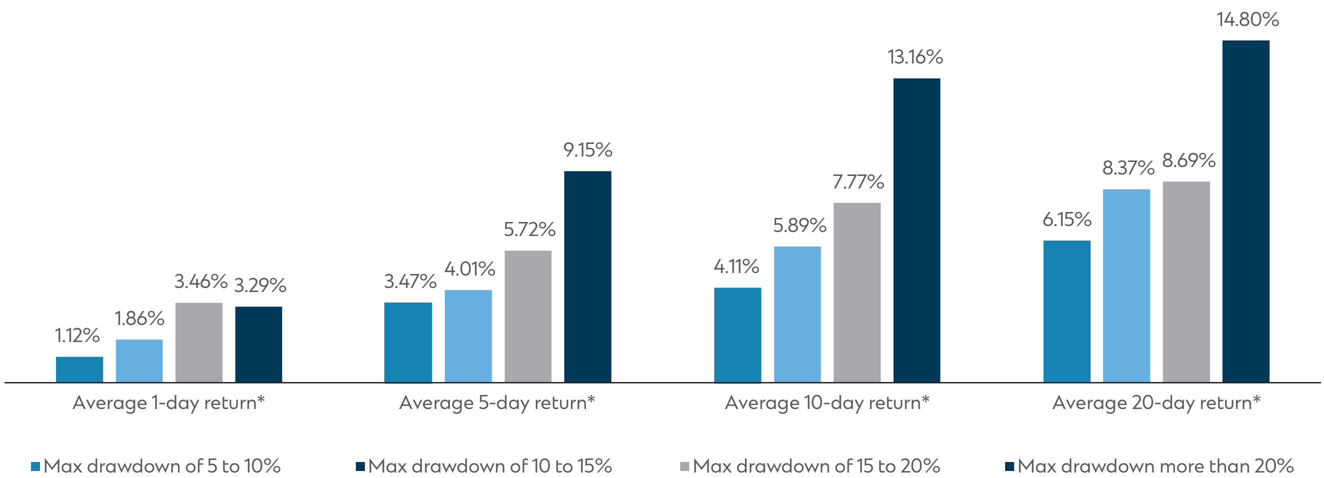
So what is the lesson for investors? It is that volatility is a normal part of investing and how you respond to this volatility is a critical determinant of your success as an investor.

It is important to remind ourselves that a market drawdown of up to 10% is not uncommon during non-recession times. History shows that if investors stayed calm and sat through some of those significant drawdowns, their portfolios would register favourable returns over the ensuing days – indeed, the longer the holding period, the higher the incremental returns. (Figure 1). This speaks to the power of spending time in the market, not trying to time the market. Panic-selling in times of sell-offs is likely to be detrimental to long-term investment performance because you will, more than likely, miss some of the best days in the markets and underperform a buy-and-hold strategy.

How we as investors behave, build and manage our portfolios plays a crucial role on portfolio performance. For us to better navigate volatility, it is paramount to understand the common sources of volatility and apply the proper time-tested guideposts to build an all-weather long-term portfolio.

Fig. 1

Time in the market matters more than timing the markets – the longer the holding period post notable drawdowns, the better the returns



Source: Bloomberg, Standard Chartered
*Average subsequent trading day returns following a trough in prices

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Common sources of market volatility

There is no exhaustive list of sources of market volatility. Apart from idiosyncratic factors such as a well-held company's earnings or outlook disappointment, here are some common sources:

1. Dramatic monetary policy tightening
2. Geopolitics and black swans
3. Recessions

The recent incidents in 2024 ticked two items off the list of these common sources of market volatility - excessive monetary tightening response/worries and geopolitics.

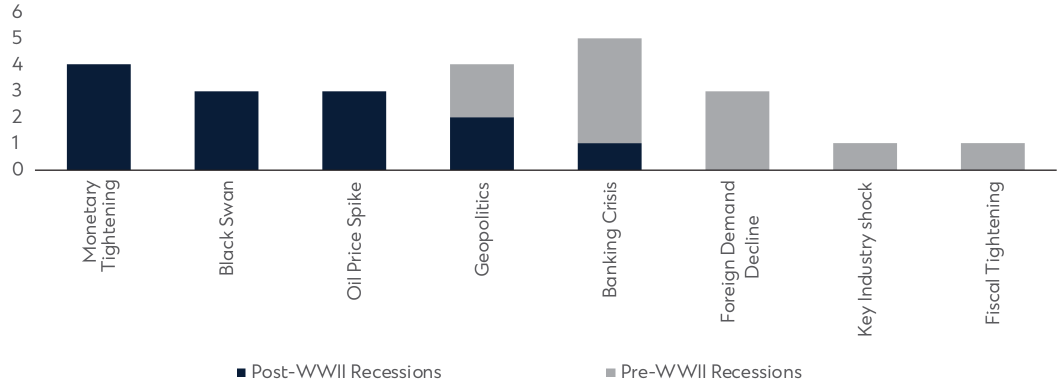
Dramatic monetary policy tightening

Historical experiences of the Fed hiking too much to combat inflation proved to be the most important culprit behind US recessions since WWII (Figure 2). Any increased fears of a more hawkish Fed can trigger a pick-up in bond market volatility, which in turn can create volatility in other asset classes such as equities and currencies (Figure 3). A case in point happened on 10 April 2024, when the March CPI data came in above forecast, stirring worries that the Fed pivot towards policy easing would be delayed. The MOVE bond market index marked the highest daily move for the year, prompting the largest uptick in the 10-year US government bond yield and close to 1% decline in the S&P 500 equity market index.

Fig. 2

Excessive monetary tightening was a leading cause of recessions

Causes of recessions Pre- and Post-World War II

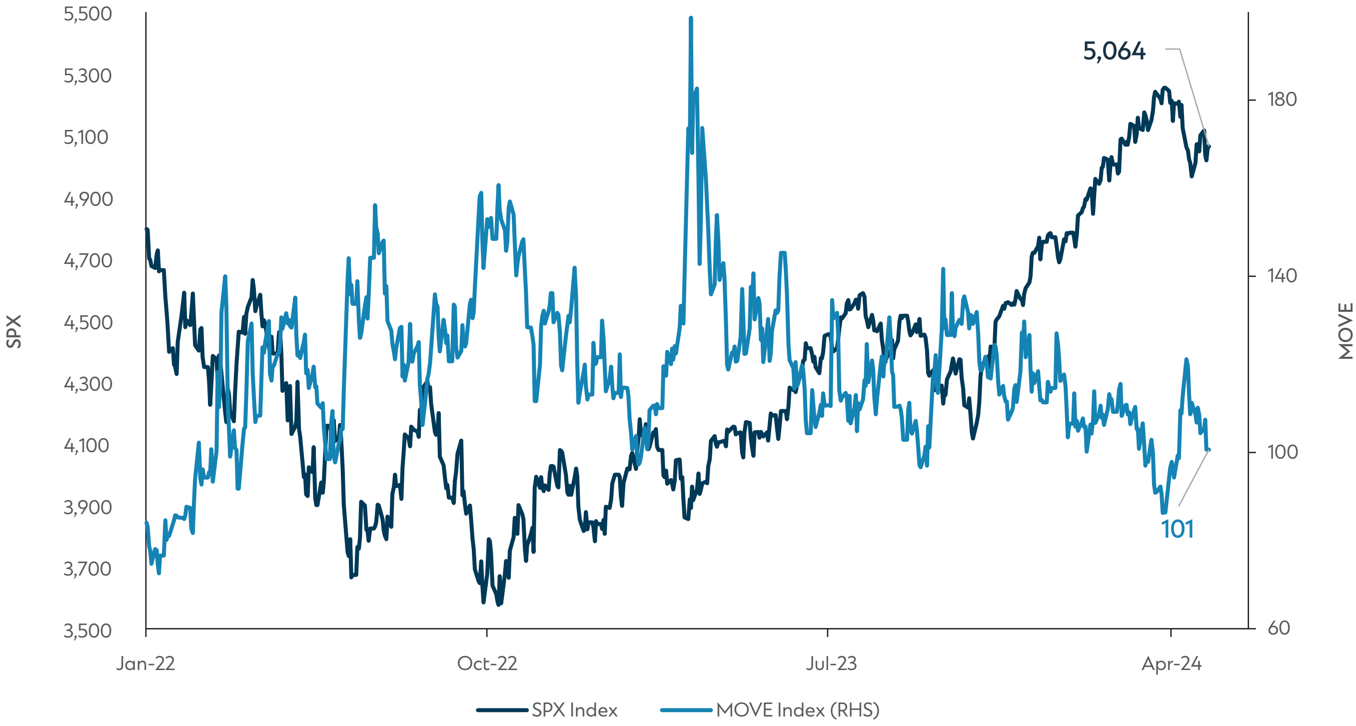


Source: Bloomberg, Standard Chartered

Fig. 3

Expectations of a hawkish Fed could trigger a spike in MOVE (bond yield volatility) and a slump of the S&P 500, albeit temporary

MOVE index vs. SPX index



Source: Bloomberg, Standard Chartered

Geopolitics and black swans

Geopolitics and black swans are multifaceted. Geopolitics entail important dimensions ranging from military conflicts to elections to trade tensions, while other types of black swans include the pandemic and asset bubble bursts. Starting with geopolitics, military conflicts sound intuitively very disruptive to the market. History since 1940, however, shows that while volatility often spikes with a notable pullback in the initial days of the conflicts, the market drawdown normally moderates quickly (Figure 4). Unless a US recession occurred in the ensuing months, the S&P 500 index recouped all their losses in 2 months on average. US equities shrugged off these war impacts, mainly because post WWII, these conflicts were "not in my backyard" and investors focused more on the US economic implications, which were largely limited.

This same line of thinking has played out this year. The Israel-Iran friction escalated into a few retaliatory attacks, which compounded by inflationary concerns in the US, led the VIX equity market volatility index to skyrocket and the S&P 500 to decline over 5%. However, the contained responses of Iran and Israel averted a full-scale confrontation. What's more, the coincident US Q1 earnings season came in largely better than feared, hence reversing the trends of VIX and markets back to pre-April levels.

Fig. 4

Wartime periods were prone to short-term pullback, while long-term performance remained robust

Start date	End date	War event	Index return since war began				
			1-week	2-month	3-month	6-month	Whole period
10-May-1940	25-Jun-1940	Battle of France*	-15.4%	-15.2%	-12.7%	-4.5%	-16.6%
7-Dec-1941	7-Dec-1941	Pearl Harbor Attack*	-6.3%	-5.0%	-12.4%	-10.2%	0.0%
25-Jun-1950	27-Jul-1953	Korean War*	-7.6%	-3.1%	1.5%	4.9%	25.8%
29-Oct-1956	7-Nov-1956	Suez Crisis*	2.6%	0.3%	-3.6%	-1.4%	1.5%
16-Oct-1962	29-Oct-1962	Cuban Missile Crisis*	-6.3%	9.6%	13.3%	21.1%	-2.4%
5-Jun-1967	10-Jun-1967	Six Day War*	4.1%	8.4%	6.5%	7.7%	3.5%
30-Jan-1968	23-Sep-1968	Tet Offensive	-1.1%	-2.9%	5.1%	5.2%	10.1%
6-Oct-1973	25-Oct-1973	Yom Kippur War	1.4%	-14.0%	-10.0%	-15.3%	0.6%
2-Aug-1990	28-Feb-1991	Gulf War	-3.3%	-10.3%	-11.3%	-2.4%	4.4%
20-Mar-2003	15-Dec-2011	Iraq War*	-0.8%	5.0%	13.7%	18.3%	38.8%
20-Feb-2014	21-Mar-2014	Crimean Crisis*	0.8%	1.4%	1.8%	8.0%	1.5%
8-Apr-2017	12-Jun-2018	North Korea Crisis*	-1.1%	3.3%	3.0%	8.2%	18.3%
24-Feb-2022		Russia-Ukraine*	1.7%	-0.4%	-8.1%	-3.4%	-
7-Oct-2023		Israel-Hamas*	0.4%	6.4%	9.0%	20.8%	-
13-Apr-2024		Iraq-Israel*	-3.0%				-
Average			-2.3%	-1.2%	-0.3%	4.1%	7.1%
Average (*only for conflicts without US recession following)			-2.6%	**1.0%**	1.1%	6.3%	7.8%

Source: Bloomberg, Standard Chartered

Military conflicts aside, the market implications of the upcoming November US presidential election and any possible trade war that could emerge from another Trump presidency are top of minds these days.

The good news is that election years have generally been good years for the US stock market (Figure 5). Of course, this time feels different. Trump, as the Republican presidential candidate, has been advocating a 60% tariff on China imports. This is reminiscent of the years of 2018-19 during his trade war with China which led to significant spikes in stock market volatility during the period. Of course, this did not get in the way of a 30% rally in the US stock market between Trump's election and the COVID-induced sharp recession, leading to the strong outperformance of US equities vs. China (Figure 6).

Fig. 5

S&P 500 historically performed well in election years

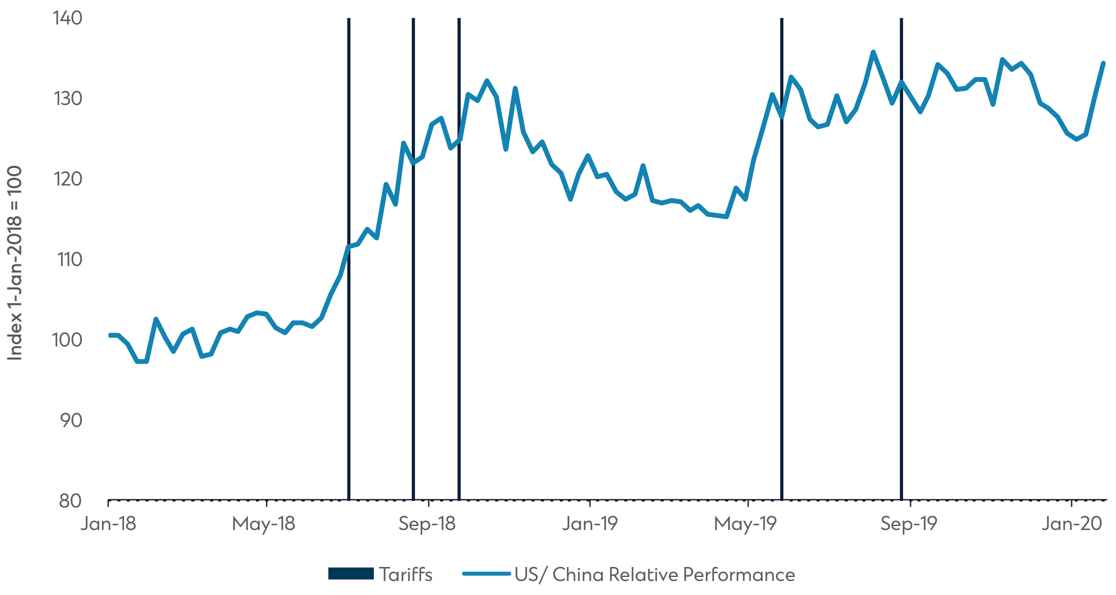
Average election year returns/change since 1928*

		Average Returns				Average Change (bps)
Incumbent	**Elected**	**S&P 500**	**US Treasuries**	**US dollar**	**EM equities**	**Fed Funds Rate***
Republican	Republican	13.2%	8.3%	3.8%	28.7%	96.8
Republican	Democrat	-2.7%	10.2%	2.7%	-9.9%	-137.5
Democrat	Republican	8.9%	6.7%	4.2%	-11.6%	175.0
Democrat	Democrat	10.4%	2.3%	1.7%	9.5%	-12.5
Unconditional		7.5%	7.6%	3.3%	2.6%	25.9

Source: Bloomberg, Standard Chartered Global Chief Investment Office. *Calculations for average returns are based on the availability of data for the underlying. S&P 500 (1928-2020), US Treasuries (1976 - 2020), US dollar (1968 – 2020), EM equities (1988 – 2020), Fed Funds Rate (1972 – 2020)

Fig. 6

US' imposition of tariffs to China led to US equity outperformance



Source: Bloomberg, Standard Chartered

Recessions

Recessions are the most painful source of market volatility, in the sense that the associated drawdowns were larger in magnitude and longer in duration (Figure 7). Recessions could result from one driver, or a combination of the factors, discussed above. In addition, it is worth noting that three of the latest US recessions could be caused by "black swans" - namely, the COVID pandemic in 2020, the Global Financial Crisis in 2007, and the bust of the dot.com era in 2001.

Fig. 7

Recessions: Greater volatility and drawdown if recession was triggered

Average Drawdown	**-31.2%**
Average Drawdown Duration (in Days)	**206**

Name	Peak date	Trough date	Drawdown	Drawdown duration	Recovery date*	Recovery duration
Monetary tightening, Inflation, Energy crisis, Geopolitics	1-Nov-1973	3-Oct-1974	-42.2%	336	21-Sep-1976	719
Monetary tightening, Inflation, Energy Crisis	13-Feb-1980	27-Mar-1980	-17.1%	43	14-Jul-1980	109
Monetary tightening, Inflation, Energy Crisis	11-Aug-1981	12-Aug-1982	-23.5%	366	11-Oct-1982	60
Monetary tightening, Inflation, Geopolitics	16-Jul-1990	11-Oct-1990	-19.9%	87	13-Feb-1991	125
Black Swan – Dot com	21-May-2001	21-Sep-2001	-26.4%	123	2-May-2006	1684
Black Swan – GFC	10-Dec-2007	9-Mar-2009	-55.4%	455	8-Feb-2013	1432
Black Swan – Covid	19-Feb-2020	23-Mar-2020	-33.9%	33	18-Aug-2020	148

Source: Bloomberg, NBER, Standard Chartered.
*Recovery date is taken as the date that the index reaches its previous peak.

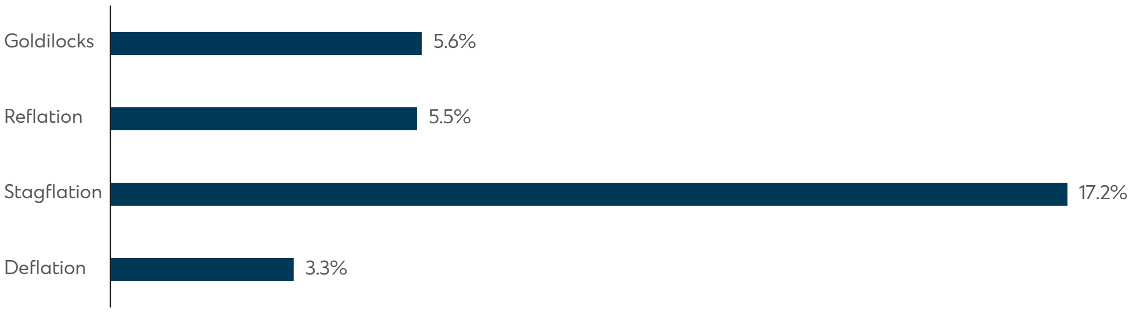
How to manage volatility?

If volatility is triggered by monetary tightening in response to inflationary pressures, gold has delivered superior returns, based on our tracking of different growth/ inflation regimes (Figure 8). Broadly speaking, gold and liquid alternatives provide protection by moderating portfolio volatility when inflation is high (Figure 9).

Fig. 8

Gold delivered superior returns as inflation accelerates

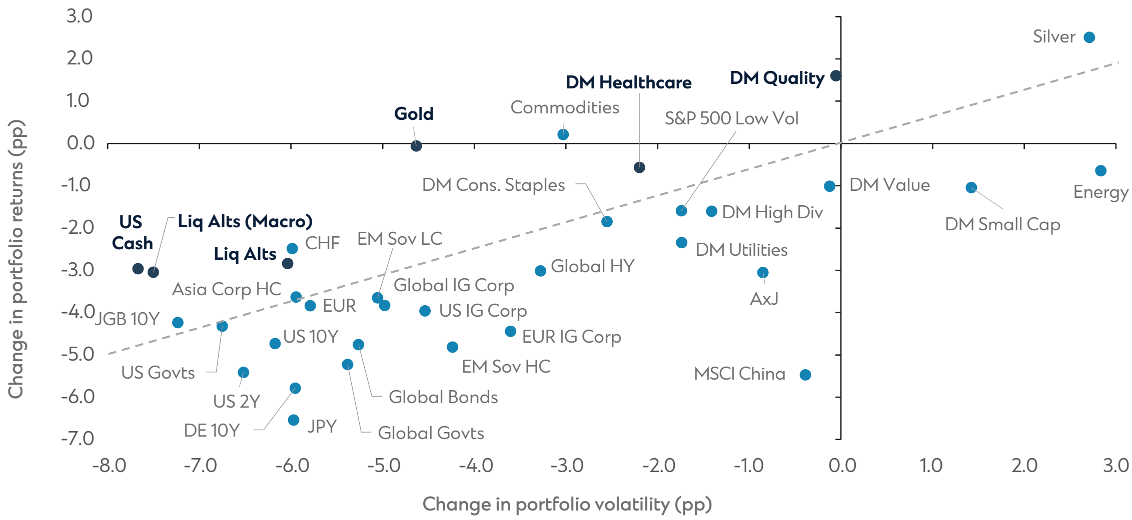
Average annualised returns of Gold in various growth/inflation regimes since Q4 1959^



Source: Bloomberg, Standard Chartered
^ Goldilocks: Deceleration in inflation, acceleration in growth. Reflation: Acceleration in growth and inflation. Stagflation: Acceleration in inflation, deceleration in growth. Deflation: Deceleration in inflation and growth

Fig. 9

Gold and liquid alternatives improved portfolio volatility when added to a 60/40 portfolio*



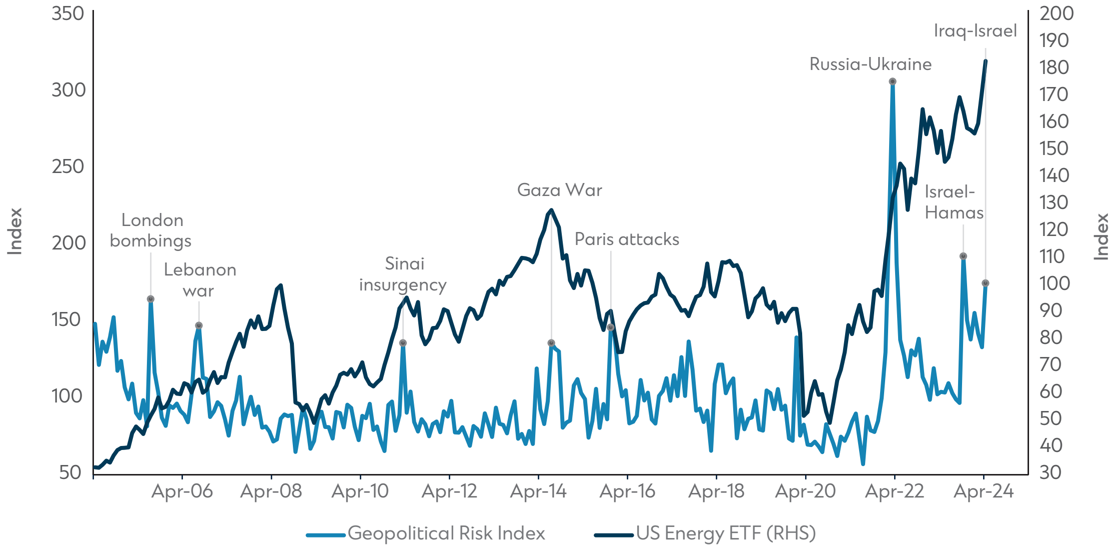
Source: Bloomberg, Standard Chartered
*Change in portfolio returns and volatility from a 100% Global Equities portfolio to a 60% Global Equities/40% Diversifier portfolio, Calculations based on data from Jan 2020 to Nov 2023

Apart from gold, oil is another key commodity that benefits from heightened geopolitical risk premium. Wars, in general, are inflationary. Tensions in the Middle East threaten the energy supply chain, impeding production and/or transportation of oil products. Therefore, energy ETFs can function as a hedge against inflation upside and geopolitical risks. Given geopolitics tend to have a transitory impact on stocks, investors should be disciplined and stay invested.

Fig. 10

US Energy Sector ETF (XLE) traded well on flare-up in geopolitical tensions

US Energy ETF vs. Geopolitical Risk Index



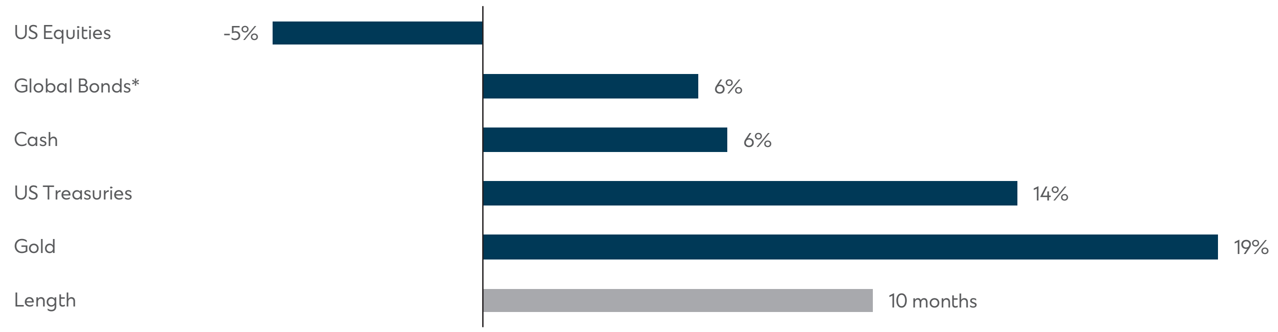
Source: Bloomberg, Standard Chartered

It is intuitive to think “cash is king” when times are bad. The reality is that gold and US government bonds provide effective ballast during recessions, delivering an average positive return of 19% and 14%, respectively (Figure 11). As such, a foundation portfolio diversified broadly across asset classes has proven to outperform a typical 60/40 equity/bond portfolio during economic downturns.

Fig. 11

Gold and US government bonds as effective ballasts during recessions

Annualised average returns of past recessions



Source: Bloomberg, Standard Chartered

Black swans that cause a recession could come in an unpredictable timing and nature, which complicates how we manage our portfolio. A powerful shield to fend off the unknowns is to build and maintain a diversified portfolio well in advance. Figure 12 shows that while no particular asset class can generate outperformance year after year, a strategic asset allocation will help smooth overall portfolio return and volatility.

Fig. 12

No asset class generates outperformance year after year

Performance of asset classes in descending order every year since 2013 (2024 denotes year to 28 May 2024)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
US Equities 31.8%	US Equities 12.7%	Govt EM 1.2%	Commodities 17.0%	AxJ Equities 41.7%	Global Bonds -1.2%	US Equities 30.9%	AxJ Equities 25.0%	Commodities 28.7%	Commodities 14.6%	US Equities 26.5%	Commodities 11.9%
SAA 9.3%	Govt EM 7.4%	US Equities 0.7%	DM HY 14.3%	US Equities 21.2%	DM HY -4.1%	AxJ Equities 18.2%	US Equities 20.7%	US Equities 26.5%	DM HY -12.7%	SAA 14.7%	US Equities 11.4%
DM HY 7.3%	AxJ Equities 4.8%	SAA -2.7%	US Equities 10.9%	SAA 16.1%	Govt EM -4.3%	SAA 17.8%	SAA 13.9%	SAA 7.9%	SAA -15.7%	DM HY 14.0%	AxJ Equities 9.3%
AxJ Equities 3.1%	SAA 2.5%	DM HY -2.7%	Govt EM 10.2%	DM HY 10.4%	US Equities -5.0%	Govt EM 15.0%	Global Bonds 9.2%	DM HY 1.0%	Global Bonds -16.2%	Govt EM 11.1%	SAA 2.9%
Global Bonds -2.6%	Global Bonds 0.6%	Global Bonds -3.2%	SAA 5.7%	Govt EM 10.3%	SAA -5.6%	DM HY 12.6%	DM HY 7.0%	Govt EM -1.8%	Govt EM -17.8%	AxJ Equities 6.0%	DM HY 2.8%
Govt EM -5.3%	DM HY 0.0%	AxJ Equities -9.2%	AxJ Equities 5.4%	Global Bonds 7.4%	Commodities -14.2%	Commodities 9.5%	Govt EM 5.3%	Global Bonds -4.7%	AxJ Equities -19.7%	Global Bonds 5.7%	Govt EM 1.7%
Commodities -8.0%	Commodities -23.2%	Commodities -29.2%	Global Bonds 2.1%	Commodities 6.6%	AxJ Equities -14.4%	Global Bonds 6.8%	Commodities -10.1%	AxJ Equities -4.7%	US Equities -19.8%	Commodities -14.6%	Global Bonds -3.3%

Source: Bloomberg, Standard Chartered
Strategic Asset Allocation is a long-term investment strategy that denotes how much is allocated to various asset classes in a portfolio. This SAA is key to building healthy foundation portfolios with optimal risk-adjusted returns, as a "through-the-cylce" guide based on one's financial goals, risk tolerance and investment horizons.

In summary, it is critical for us as investors to prepare for the rainy days, and build a well-diversified foundation portfolio over time to protect our investments against any extreme market volatility.

Appendix

A holistic approach to managing your wealth Today, Tomorrow and Forever

SC Wealth Select

Has your portfolio had a health check lately?

Keeping in shape is important for good health and well-being. But what about your financial health? Are you ensuring that your portfolio stays financially fit?

Just like you get regular check-ups to stay on top of your health, it is important to give your portfolio regular check-ups to ensure it is in optimal condition for your financial well-being.

To help you stay on track with your financial goals, reach out to our wealth specialists to arrange a portfolio review. Our team follows a holistic approach to ensuring your wealth is managed to suit your Today, Tomorrow and Forever needs. We will guide you using our investment principles and ensure that your portfolio is adjusted to reflect any change in your financial goals.

Everyone approaches their wealth differently. However, what truly matters is that you feel in control of your wealth journey and are well-positioned to secure your financial future. As you plan out your next health review, make sure you undertake a portfolio review too.

Purpose

Today, Tomorrow, Forever

Our approach to wealth management is built on your vision of Today, Tomorrow and Forever for yourself, your family and beyond. As you move through life, your needs, life goals and preferences change. However, at every stage, clearly defined goals help to anchor your investment decisions.

Using a 'Today, Tomorrow and Forever' approach, we distinguish the assets intended to be used in the near term (Today) from the assets that are to be used over decades (Tomorrow and Forever), thereby segmenting your portfolio into different strategies that can help you meet your short- and long-term goals.

'Today, Tomorrow and Forever' planning is unique to you. Our specialists partner with you to build well-diversified, long-term Foundation portfolios aligned to your Today, Tomorrow and Forever needs. Opportunistic ideas are added to capture short-term opportunities, and sufficient protection included to address your and your family's objectives.

Today, Tomorrow, Forever Approach

Planning for Today
Requires ensuring liquidity and income flows take centre stage.

Securing Tomorrow
Entails a well-diversified investment and protection portfolio with a focus on growth, while ensuring inflation is accounted for and risks are mitigated.

Building for Forever
Involves greater focus on long-term returns given the time horizon of the portfolio can be measured in decades, and might also include business interests, real estate, collectibles, or charitable funds.

Principles

that stand the test of time

Adhering to time-tested principles, to ensure your investment decisions remain robust and consistently applied, is paramount to your success Today, Tomorrow and Forever. We use five Wealth Principles to guide and guardrail your wealth decisions.

Discipline – Ensure consistency and prudence over your emotions

- Reacting to emotions such as optimism and fear can lead to poor investment decisions at the worst times
- Have a plan and stick to it – this helps you to stay focused on the bigger picture

Diversification – Simply put, don't put all your eggs in one basket

- Reduce risk by holding a variety of financial assets. Multi-asset diversification in your Foundation portfolio is important
- As a guide, make sure your portfolio contains a variety of asset classes and investments that have low correlation with one another

Time in the Market – A more robust strategy than timing the market

- Predicting market sell-offs is challenging, and timing your exit and re-entry is difficult
- Missing out on the best performing days of a market can have a significantly detrimental impact on your portfolio
- 'Time in the market' and buying the market with a longer-term view provide more consistent returns that can ride out bumps along the way

Risk and Return – Make sure the risk is worth the return

- To achieve higher investment returns, you will likely have to accept a greater level of risk in your portfolio
- Therefore, it is important to understand the risks and manage these on an ongoing basis

Protection – Don't let the unexpected catch you unprepared

- Even though you may feel healthy, or financially stable now, protection offers the ability to overcome times of financial uncertainty and mitigate the long-term impact of unforeseen events on your wealth
- A good protection plan not only safeguards your wealth today, but also considers the value of your future earnings over your lifetime, in today's terms

Process

Following a holistic approach to managing your wealth

We follow a rigorous process to ensure your needs and objectives are well-understood, and your portfolio is aligned and managed to deliver on these objectives.

However, markets constantly evolve and your needs change. Hence, we encourage you to undertake regular portfolio reviews to ensure your portfolio remains aligned to your Today, Tomorrow and Forever objectives. This proactive approach includes strategic rebalancing based on insights from our Chief Investment Office.

Learn more

Scan the QR code below to learn more about our SC Wealth Select approach to growing, managing and protecting your wealth.

The five-step process

1. **Showcase** Demonstrate how SC Wealth Select can help you
2. **Discover** Understand you better – your needs, preferences and goals
3. **Propose** Design a Foundation portfolio tailored for you with Opportunistic overlays
4. **Implement** Seamlessly and efficiently
5. **Monitor and review** Regularly review and rebalance your portfolio

Please be sure to reach out to your Relationship Manager today to arrange a portfolio review.

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