Weekly Market Summary

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What Differentiates a Healthy Correction from a Chaotic One? Depends on Whom You Ask!

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Latest Update on Coronavirus: Confirmed cases last at 28.36 million, with the death toll from the pandemic at 914,470. Donald Trump's admission that he downplayed the gravity of the Coronavirus in February so that he wouldn't cause panic among Americans have led to accusations that the US president misled the public about the severity of the virus. China has begun testing a nasal spray vaccine for the coronavirus in what would be a world first. US Senate Democrats have blocked a narrowly tailored pandemic relief plan proposed by Republicans, contending the measure is too meager a response given the damage that Covid-19 continues to wreak on the US economy. Japan and Singapore plan to open a reciprocal green lane for travel next week in a bid to revive business between the two Asian countries; And UK Prime Minister Boris Johnson is facing open revolt from some Tory MPs over new lockdown restrictions including the "rule of six" (social gatherings limited to six people now in England! Where is this world headed?!)

A market correction is defined as a rapid change in the nominal price of a commodity from its recent peak level, as developing fundamental and technical factors lead to the establishment of a new equilibrium price. In the field of finance and investments, a market correction usually refers to a decline of 10% or more in the price of securities – such as individual stocks, currency markets, indices and any asset which can be traded on an exchange. Whilst capital markets may at times fall into a correction for days, weeks, months or a longer sustained period of time, market corrections are generally short-lived and last anywhere between a week to a month as per recent financial performance (in contrast, a bear market is defined as a decline in prices of 20% or greater and can last for longer period of times)

For many investors and analysts, market corrections are an indicator of a healthy stock market (try telling that to the herd that purchased Tesla or FAANG shares at the end of August! ☹), as a continuous rise in the equity market might have adverse implications for an economy, such as high levels of future inflation expectations or increased risks of actual asset bubbles. That fall in prices is significantly different from bear market selloffs, as smaller corrections allow an economy to grow even further upon readjustment of the prices of securities as per their real and fair value. Still, market corrections do give off a scary vibe (irrespective if good or bad omens) and can often push tumbling prices into a true and lasting crash (at which point the US Plunge Protection Team would be out in full force to save the day, executing multiple trades on several exchanges with the collaboration of big banks, such as Goldman Sachs, JPMorgan and Morgan Stanley in unrecorded transactions .. *To Infinity & Beyond* 😊).

Almost a week back, specifically last Thursday September 3rd , the mega cap tech shares that had driven stocks to records over recent months (with the Nasdaq 100 index gaining in 11 of 13 sessions to notch records almost daily) plunged as bears reclaimed the upper hand on US equity markets, at least for that day. The Nasdaq 100 sank as much as 5.4% and posted its biggest rout since June. Apple, Tesla and Amazon - previously among the biggest contributors to the historic and powerful five-month rally - lost at least 5.1%. The next day, and despite the release of a better-than-forecast August Non-Farm Payroll number, US stocks ended again lower – sending the market to its worst weekly loss since mid-June and technology shares to their biggest weekly decline since March.

The Catalyst?

As it turns out (following confirmed press reports over the weekend), Masayoshi Son's conglomerate – SoftBank Group Corp., was behind the spectacular ride in large-cap US technology stocks in recent weeks that lifted the broader market and, in effect, made investors nearly forget the Covid-19 crisis for a moment. The "*Nasdaq Whale*", as the FT calls the Group, appears to have made a monstrous options trade that effectively amounted to spending billions of dollars on purchasing out-of-the-money call options tied to around $50 billion worth of individual tech stocks (forcing those on the other side of the trade to buy more options or simply buy the underlying stock to hedge their short positions). And while all the tech giants have benefited in some way from social shifts brought on by the pandemic – a surge in demand for everything from online shopping and streaming-videos, to work-from-home software solutions – investors and market observers had struggled to explain exactly why their share prices took an extra leg up over the summer and were left pondering whether to stick with a responsibly diversified portfolio that would be destined to underperform, or chase the frenzy!

Whilst it is unusual for options-buying tied to individual stocks to be so explosive that it could move markets in such big way, it appears that it is now the prevailing theory. Equity derivatives (similar to toxic credit derivatives in the run to the 2008 financial meltdown) have also become a favorite trading toy for presumably bored, stuck-at-home, retail investors who have seen their volumes increase on easily accessible, free-trading platforms such as Robinhood. It is hard to know Son's specific motivations for joining that camp, but it is surely not boredom or excitement! Was the "*true visionary*" investor - who once spoke of a 300-year plan for Softbank and more recently bragged about the short 45 minutes it took him to convince the Saudis to invest $45 billion - turning into reckless gambler or a long-equity hedge fund manager?

As Bloomberg columnist John Authers notes in a recent market piece, "*If there is a bubble in the biggest tech companies. It is arguably in their profits; And how they have been allowed to build up monopolistic market power, rather than in their valuations.*" Still, the tech bubble has begun deflating now, and news of Son's almost single-handed influence won't help matters going forward.

Below, we leave our readers with a coverage of major stories that have shaped our world/markets over the past week:

- ***Oil Prices Face a Chill Autumn Wind:*** The recovery in oil demand has officially stalled, just as the OPEC+ countries are starting to taper their record output cuts. That is the verdict reached by oil traders this week as prices of underlying Brent and West Texas oil contracts continue their sharp slide (almost 14% down move for both grades since late August) following a sharp initial rebound from the depths of the pandemic-induced slump during the May/August period. With spare capacity rife throughout the supply chain and huge stockpiles of crude and refined products still present, it may be some while yet before oil prices resume their upward path. Brent and West Texas' November futures last at $39.90 and $37.60 a barrel respectively.

- ***Increased Chances of a Messy UK-EU Split:*** The UK and the European Union are heading for a chaotic split without a new trade deal as talks between the two sides almost collapse. During crisis meetings yesterday, Prime Minister Boris Johnson's government rebuffed an EU request to scrap his plan to re-write the Brexit divorce accord, even after the bloc gave him a three-week ultimatum to do so and threatened legal action. The dispute risks jeopardizing already faltering efforts to secure a trade deal between the two sides by December 31st, when the Brexit transition period concludes. That in turn would trigger tariffs between the UK and the world's biggest single market and delay commerce with extra paperwork at the border. The British pound is now headed for its biggest five-day fall in almost six months versus the dollar – last trading at $1.2829 (down from a high of $1.3482 on September 1st, 2020).

- ***Will the US Federal Reserve New Approach Make Any Difference?*** In a Bloomberg opinion piece released last Wednesday, Mervyn King (who served as the Governor of the Bank of England from 2003 to 2013) questions whether the Fed's recently announced "*average-inflation*" targeting strategy at the virtual Jackson Hole symposium is a substantive pragmatic response to new conditions or simply something to say after a highly publicized review made it necessary to come up with a fresh idea? (I pick … the latter 😊) Lord King's view is that the "*inflation targeting*" and "*average-inflation targeting*" policy responses are quite different. In principle, inflation targeting continuously pursues a future inflation rate of 2.0%, ignoring any past deviations; Average inflation (or price-level) targeting tries to "*make up*" past deviations of inflation from target. Nonetheless, committing in advance to make up shortfalls or overruns of inflation will surely result in greater volatility of employment and output.

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