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MARKET VOLATILITY: OUR VIEW

Neil Woodford, 25 August 2015

Throughout my career as a fund manager I have been reminded, regularly, of the markets' ability to surprise and alarm investors. It really is at times like this when Kipling's advice to keep your head when all about you are losing theirs, is particularly apt.

The past few weeks in global financial markets has been just such a time. It appears that investors everywhere are dramatically rebasing expectations. The principal trigger for this market rout has been the combination of weak macro data from China along with the precipitous fall in Chinese equity prices, which has confounded the authorities' increasingly clumsy and apparently desperate attempts to stabilise the market.

Regular readers of our blog will not have been surprised by either of these events. We have spoken about the equity market correction in China, which started in earnest in June and have been commenting on the weak China growth story for more than a year. Indeed, the strategy I have pursued since June last year has emphasised the weak global economic backdrop, led by slowing growth in China and its impact on global commodity prices.

I say this now to remind investors that these events, which triggered yesterday's global equity panic have been embedded in the expectations that we have in place for the stocks we have chosen to invest in – and indeed those that we have chosen not to.

Consequently, little that we have seen recently with respect to macro fundamentals has come as a surprise, including today's policy response in China (lower rates and more liquidity) or for that matter Renminbi devaluation.

We remain cautious of the global growth outlook and, on balance, believe that interest rate increases, both in the US and here in the UK, are further off than consensus has hitherto believed. Weak global growth and productivity, deflation and excessive debt remain our principal concerns.

With respect to the UK, where growth has been comparatively strong globally, we worry about the unbalanced nature of that growth (disproportionately led by consumer spending, which is reflected in the disastrous balance of payment deficits in recent history).

At the corporate level, we have also commented on the dangers posed by the gap between equity valuations (inflated by QE) and economic fundamentals. This is especially relevant because of the weak earnings backdrop.

We will continue to focus on businesses that do not need a broad economic revival to meet expectations but, as always, we will also look for opportunities in areas of the market where the falls have been heaviest and where we may not already be exposed.

It is always difficult to remain focused on fundamentals when markets fall dramatically. The distraction of seeing share prices fall indiscriminately can be overwhelming and distort rational perspectives. At times like this, having a few grey hairs helps, as does reminding yourself of Kipling's timeless adage.