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28 October, 2020

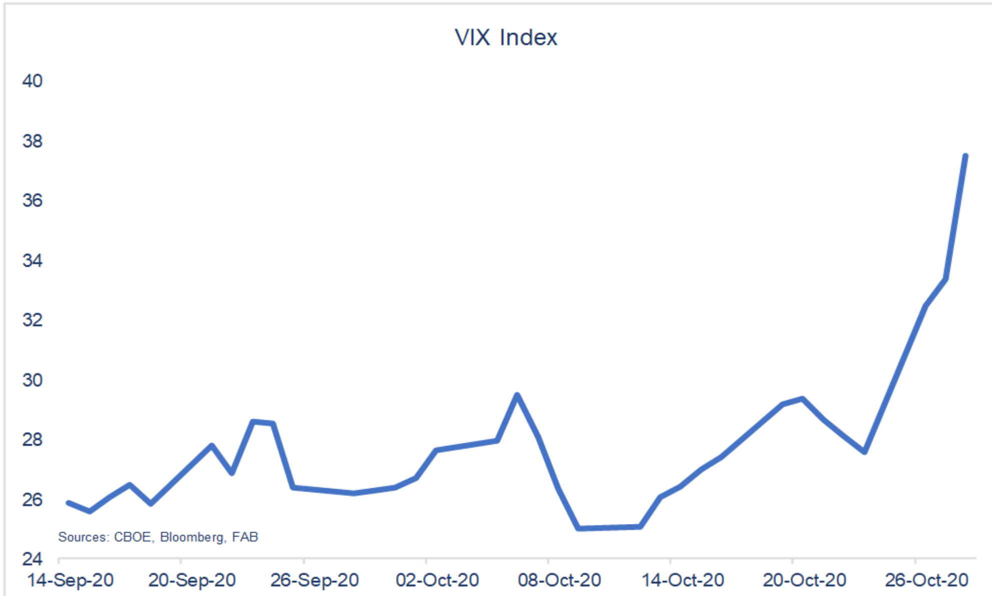
Volatility could rise, but that does not have to be a bad thing

- **The S&P 500 index seems headed for a third day of losses as stocks in Europe plunge.**
- **The CBOE Volatility Index, the VIX, has risen 31% this week alone.**
- **The prospect of economic shutdowns in the Northern Hemisphere along with election uncertainty in the US suggest more downside.**
- **Judging from history, however, central bank liquidity and low interest rates are likely to push average volatility down over time.**
- **The FAB AAC remains slightly underweight in equities, and overweight in IG bonds and gold**

It is not completely unexpected, still global investors are not liking it. With the number of coronavirus infections rising as the cold weather advances in the North, Germany instituted curfews and more restrictions, and France is expected to announce a national lockdown today.

While the US is still not seen taking the same path as France, if the Democrats take over the White House they could also opt for national restrictions in January, when the virus is still expected to be rampant and the president elected in next week's polls takes office.

These actions could slow down the global economic recovery just as it is picking up steam, particularly in the developed nations which were getting out of lockdowns. Stock markets have to price that in, and that is just what they are doing. As a result, volatility is rising, and could continue to do so for a few days.



The S&P 500 is on track for its third daily loss today after logging its first negative week in four last week. Depending on how much the index drops during US hours, it could breach a key technical barrier and prompt a round of stop-loss trades, which may temporarily exacerbate the selling.

These events are being reflected on the CBOE Volatility Index, the VIX, which has risen nearly 10 points so far this week to 36.97 at writing. A couple of weeks ago that move upward may have been curbed by the unwinding of volatility hedges, but these positions have been reduced sufficiently that they are unlikely to act as a significant curb to another leg up.

Add to all this the uncertainty surrounding the outcome of the US election and the next few days promise to be bumpy for investors. However, that may not necessarily be so bad. In fact, a correction may allow for an entry point for longer-term investors and for some profitable short-term volatility trades.

The cost of volatility hedges has been rising this week, together with the VIX index

Ultimately, the old market adage "don't fight the Fed" still holds. The Federal Reserve is unlikely to let markets spiral downwards and could act if things start looking out of control. The ultralow interest rate environment and the liquidity pumped into the system by global central banks has also in the past translated into lower average volatility for stocks.

Once the election results are clear, whenever that is, analysts expect the US Congress and the White House to reach an agreement on a new fiscal stimulus package. These things combined still point at future gains for risk assets such as stocks and high-yield bonds. It could take brave investors, however, to face the market moves in the next few days and deploy cash.

Investment Strategy Update

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