

# Bull market is still intact, despite volatility

By Nick Armet, 19 May 2010

**Despite recent fears over government debt levels in the eurozone, investors should be reassured that the bull market in equities remains intact.**

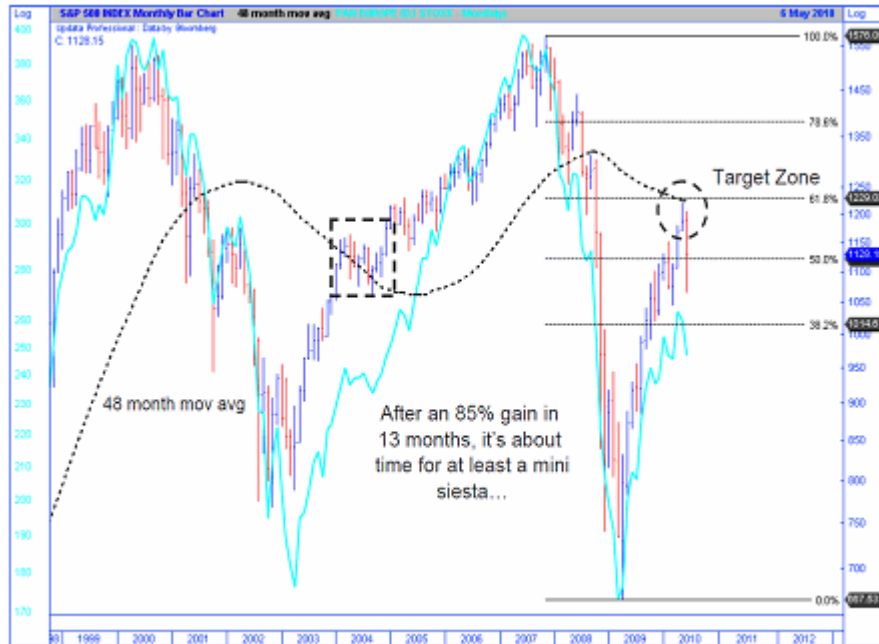
Volatility has resurfaced in the markets. This time the trigger for investors selling risky assets was Germany's decision to ban 'naked' short selling. The news comes hard on the heels of market fears over government debt levels among some of the weaker European economies. Although, the announcement of a €750 billion rescue package appeared to stem a crisis of confidence in bond markets, the euro remains under pressure as investors question whether the political will remains for a common currency.

The German ban has put a curb on risk appetite when it was already fragile. The practice of 'naked' short selling is where investors seek to profit from prices declines in shares or bonds, in spite of the fact that they do not hold the underlying securities. As a result, it is considered by many politicians to be the kind of unhelpful speculation that exacerbated the impact of the Greek debt crisis. Nevertheless, the ability of a single-country ban to be useful is limited unless other countries follow suit, and, even then, the evidence that banning short-selling leads to more efficient markets is not compelling.

So, do these markets tremors indicate the good times are over? After all, stock markets have delivered strong gains since March 2009, so it's normal for investors to consider whether the recent market volatility represents a shift to a more negative phase or, at worst, an end to the bull market in equities?

There are a number of reasons why this is unlikely, not least the fact that global economic and corporate data releases have been healthy. The stock market itself is an excellent discounter of the future. This is why technical analysis can play a crucial role in providing the right context to investors. For example, a classic hallmark of a bull market is that highs in the index become 'higher highs' and lows become 'higher lows' as the market moves forward. This is just one of the reasons why we can say that the sharp corrections we have experienced today and in recent weeks are healthy pullbacks within a bull market, rather than a more dangerous signal of a transition to a bear market.

Another interesting aspect of recent events is that markets initially broke down at a technically significant level – when the US S&P500 (red and blue line on the chart) Index was approaching its four-year moving average (black line). The last time the index intersected this moving average was in 2004. It also sparked a period of consolidation at that time. After a big earthquake event like the credit crunch, there are always a series of smaller aftershocks to overcome during the subsequent recovery.



Source: Datastream, as at 10.05.10.

The technical outlook for equity markets suggests a W-shaped recovery. We may be in the second down-leg of that W. We should expect to see further pullbacks, but these periods of consolidation should be viewed as buying opportunities. Economic policy in the eurozone will remain a key focus of attention, as will the outlook for the Chinese domestic economy, where a significant deterioration in the property sector could have negative implications for stocks sensitive to global economic growth.

Equity markets should finish the year on a positive footing. Leading indicators of business activity are now peaking, suggesting that global growth is strong, but the pace of increase will start to moderate, going forward. Looking further out, that means that we can expect to see central banks begin to tighten monetary policy at some point in the next 12 months. Australia has already started down this track, but the US, UK and eurozone will inevitably follow, raising interest rates from their current, extremely low levels. This is not necessarily a bad thing for equity markets. After all, central bankers typically raise rates when economic activity is strong and inflation is becoming an issue. History shows that stock markets do not necessarily perform badly when interest rates start going up, if earnings growth is still coming through in the corporate sector.

European equity markets have performed poorly in the year-to-date. In part, this is due to concerns over sovereign debt, which have come to fore in recent days. Investors have also been reallocating their portfolios away from Europe towards emerging markets and corporate bonds. However, some of these highly favoured assets are starting to look more fully valued while European equities, by comparison, are under-owned and may offer value for those investors prepared to take a medium to long-term view. European banks have been dragging down the wider market, but it will be interesting to see how things develop from here. The rescue package makes it less likely that European banks will be negatively impacted by their eurozone sovereign exposures.

Amid the current raised anxiety levels in stock markets, it is important to remember that on most of the important measures (economic, corporate and technical), the bull market in equities looks likely to be sustained.

We can expect the market to continue to grind higher, with what should be seen as periodic, and entirely healthy, corrections along the way. Worries and risks will persist though. In every bull market, investors must climb this 'wall of worry' before outright optimism can prevail. This time is no different.

*Note the value of an investment and the income from it can go down as well as up, so you may get less than you invested. The ideas and conclusions in this column are the author's own and do not necessarily reflect the views of Fidelity's portfolio managers. They are for general interest only and should not be taken as investment advice or as an invitation to purchase or sell any specific security. Past performance is not a guide to what may happen in the future. Investments in small and emerging markets can be more volatile than more established markets. For funds that invest in overseas markets, changes in currency exchange rates may affect the value of your investment.*