REALITY CHECK??

I often like to use the term "**rocket ship phase**" when referring to a share price that exhibits short, dramatic and BIG price increases. For whatever reason, buyers push the stock price up almost vertically over a very short period. The gains can be impressive, however, much like a rocket ship when it runs out of propellant, the subsequent price fall can be just a dramatic. The challenge for investors is one, you never know how long the rise will be and selling too soon can mean missing out on some BIG impressive profits and, second, only in hindsight, does one know if the descent phase is a fall back to earth or just a temporary drop before the "second stage" kicks in.

We witnessed lots of "rocket ship" type stock chart patterns over the last few weeks and most of them ran out of gas last week. Here are a few examples:

- **Carnival Cruise Lines** – doubling from $12 to $24 in some two weeks of trading, before falling 30% in just four days
- **American Airlines** – a double in the stock price in just five days before losing 35 % over the next four days
- **Ford Motor** up 70% in a similar time frame then dropping over 20% in just three days
- Less extreme: **Federal Express**, a gain of over 40% from the 15th May to the 8th of June, then dropping 15% over the next three days.

<u>What all these companies have in common are being potential beneficiaries of the opening up of the US economy and the end of the Covid-19 restrictions</u>. What caused their decline last week, and the end of the multimarket stock rally since late March, were two key events:

1. Comments from **Fed Chairman Powell** in which he forecast a very slow US recovery, high unemployment numbers continuing (9.3% by year-end) and that interest rates would stay near zero for years as the need for the FED's aggressive stimulus would have to continue.
2. A resurgence in **COVID-19** infection rates, prompting concern about a potential second wave. And this is even before we know whether the recent and ongoing large protest gatherings will also add to a huge spike in new cases.

Bottom line: major indices were almost a mirror image of last week's big up-moves, and the only gainers were the safe havens of bonds, currencies (US dollar, Swiss franc, Japanese yen) and gold.

***I have written previously that the biggest threat to the equity markets recovery is the aptly named "second wave", and the next few weeks may well be key, in my opinion. While* Friday ended on a positive note, going forward the number of new Covid cases and, perhaps more important, hospitalizations, may well determine if this is just a short pause in the**

recovery before the “second stage” kicks in or the beginning of a fall to earth.

I want to conclude with a short comment on one force which may well be contributing to the big daily swings in stock and broader indices movements and also playing a part in the multiday huge price moves up and down that we are witnessing: The so called “**Volatility Trading”.** It stems from the creation of the VIX indicator some 16 year ago. Without getting too technical, the VIX was developed in an attempt to gauge near term future volatility of stock markets. A low reading implied investors were “unconcerned” and while a present up or down trend could continue, sudden big and unexpected price moves were unexpected. A high reading was meant to predict the expectation of volatility ahead.

This indicator has gone from a tool to help in making investment timing decisions to the basis for the development of many varied and complex betting strategies. **Today, trillions of dollars change hands annually on such strategies and Hedge Funds solely focused on volatility trading have over $19 billion in assets**. Just to be clear, unlike traditional investing of actually owning shares in a company, nothing is “owned”, it is simply a bet on direction or lack of it. Needless to say, such strategies are hugely risky as there can be no limit to the amount of possible loss. I am sure we all read of the recent loss of **over $2 billion dollars** of Albertan pension fund money when a bet that stable markets would continue in 2020 went “unexpectedly” wrong when markets collapsed in March.

Many strategists believe that the huge amount of money involved in these strategies is, in itself, causing more volatility and dramatic daily price movements as the computer based programs feed on themselves, so to speak, when an unexpected price swing develops. The development of ETFs that trade in such movements has enticed many more day traders into this type of investing. “**Day trading has replaced sports betting as a form of entertainment**," reads a headline from the US news website *Axios*.