Touch wood

This is my 54th consecutive monthly column, having been invited early in 2020 to provide a "view from the Thames". I gave a commitment to deliver my copy by the second weekend of March that year. I should have realised it was not a great omen when the calendar indicated the deadline was Friday the 13th.

As I sat writing that first piece, the world was closing down as a respiratory virus spread rapidly from country to country. Nobody had any idea of the ultimate economic impact, but it seemed reasonable to expect the worst. Asset prices went into free fall and volatility spiked.

It took all the courage of my convictions to conclude my maiden column by saying that the biggest danger for investors is never the next correction or bear market, but their own behaviour when such an event inevitably occurs: it's important not to blink at the bottom and sell out at exactly the wrong time. I conceded that it was easy to say things like this when equities are trading at or near record highs; every now and then, our resolve will, however, be tested. March 2020 was clearly such a time.

As that first column was published, the market happened to bottom and a surging bull market followed. I was lucky. Global equity indices have more than doubled since then.

I was thinking back on this when I saw the VIX (the so-called fear index) trading around the 65 level last week. If you look at a long-term graph, a number this high has only been seen twice in the past 20 years: at the peak of the global financial crisis in October 2008, and a few days after that first column of mine was published in March 2020.

I refer to a VIX history of 20 years because that is how much data we have available. Trading in futures on the VIX commenced on the CBOE Futures Exchange in Chicago towards the end of March 2004, following years of academic research and debate about its construction. You need to be a rocket scientist to understand the maths behind it. I wish I could explain it to you (but I'm not a rocket scientist).

The previous two peaks in the VIX, as mentioned before, came when it really felt as if the world as we knew it was grinding to a halt: first, the financial world in 2008, and then the entire world in 2020.

I remember discussing the similarities between these two episodes with a colleague at the beginning of the pandemic: my own view at the time was that 2008 had undoubtedly been a whole lot worse. In hindsight, I'm not sure I was correct; Covid ended up being pretty scary in terms of its market impact (not to trivialise the sickness and death it caused).

A turn for the worse?

Fast-forward to today, and, if you were to believe the VIX, we must once again be facing a similarly fearful episode.

Really? All because the Bank of Japan has decided to raise interest rates, leading to a stronger yen and the carry trade unwinding?

Was it because job numbers in the US "missed", leading to heightened fears of a recession? Or were we just looking for an excuse to dump shares because the Magnificent 7 had run too hard, and Warren Buffett gave us a fright when he admitted to lightening his exposure to Apple?

None of these sounds like the end of the world to me. Maybe it will all make sense one day, and we'll talk about it to our grandchildren as if we understood exactly what happened as each basis point unfolded.

But for now, even the market itself seems to have shrugged off the extreme uncertainty (as signalled by the VIX) at the beginning of the month. Relative peace has broken out once more and share prices have stabilised. If only the same would happen on the streets of London where we've seen some ugly riots lately.

My deadline for next month's column will once again be Friday the 13th. I can only hope that financial markets will remain calm and I won't need to retract some of the sanguine conclusions from this piece. Touch wood. x

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