Flash Crash: High Tech Stocks Fall into Correction Territory

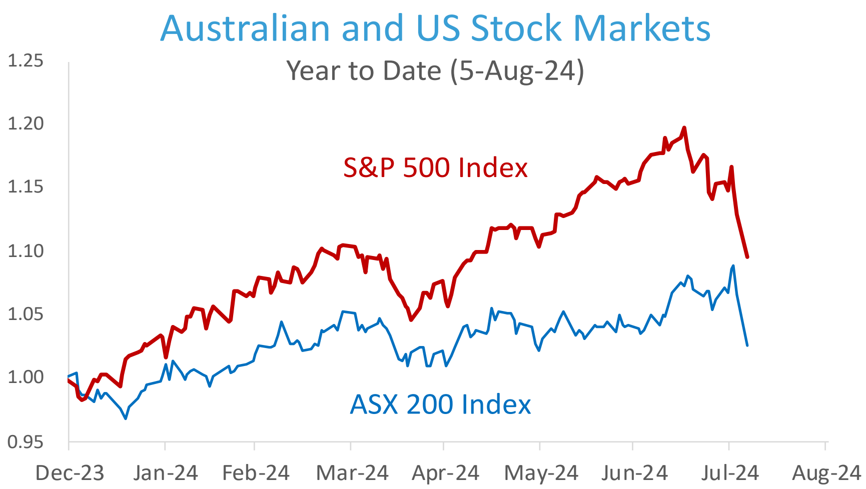
Volatility remains elevated in financial markets after the past few turbulent days. Last week saw a significant shift in sentiment, prompted by signs that the US economy is slowing down faster than previously thought. On Monday the 5th of August the S&P 500 suffered the biggest plunge in about two years and the tech-heavy Nasdaq 100 saw its worst start to a month since 2008. So, what just happened – and what is likely to happen next?

The backdrop to the global sell-off that began at the start of August - and accelerated dramatically on Monday 5th August – can be seen in the light of a surprisingly optimistic market, seemingly ignoring some of the stresses in the global economy. The US sharemarket, buoyed by the excitement around artificial intelligence that had boosted the prices of the mega technology stocks, was trading near record highs, even as some unease about the economics of AI were starting to emerge.

Following the Federal Reserve meeting at the end of July, in which US interest rates remained on hold, equity and bond markets were increasingly confident that the long anticipated cuts to US interest rates would begin in September. However, an unexpectedly weak US jobs report, which raised renewed fears of a recession in the world's largest economy, hit at the same time as other tensions in the global economy were building, sending stock markets into a dramatic downturn.

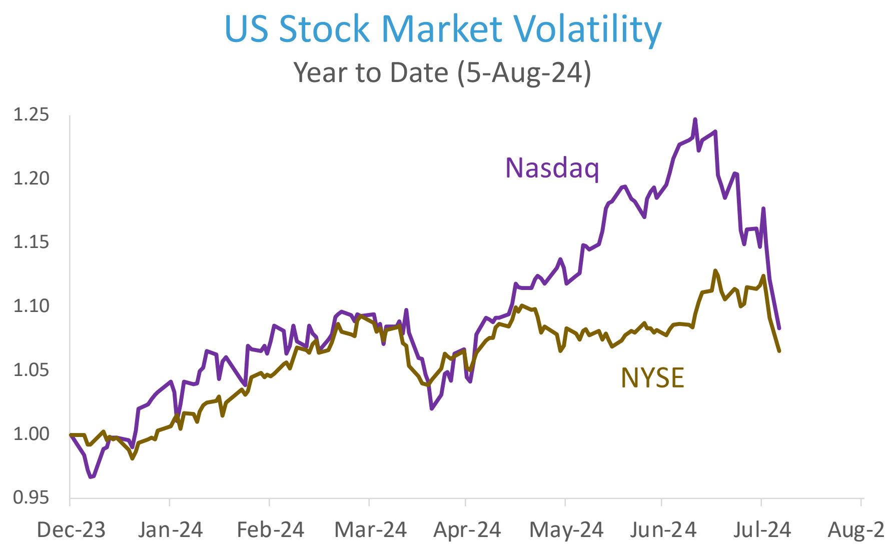
The impact of this sudden reaction can be measured by the VIX index, which is an indication of the expected volatility of the US stock market. This is often called Wall Street's "fear gauge", and on Monday 5th August it registered its biggest spike in data going back to 1990. The chart below shows the VIX since the start of this year, keeping in mind that the volatility levels were historically low before the "flash crash".

The associated fall in markets was severe. While the US market was down “only” 3% on Monday, Japan’s Nikkei index was down 12%. Other Asian markets experienced a brutal sell-off, and here in Australia the S&P/ASX index was down 3.7% on the day. However, as the chart below shows, the US markets was already wobbling before the events of early August.



Weighing down the overall US market was the same narrow cohort of big tech stocks that had been driving the market for the past year or so. The largest stocks in the world – Microsoft, Apple and NVIDIA, and other tech related stocks - had come off their highs after an average reporting season. The market took the less than stellar results as a signal that perhaps the enthusiasm for artificial intelligence was greater than the future economic benefits.

The US market is often represented by the S&P500 Index, but the constituents of that index trade on two major exchanges – around 54% of stocks are on the NYSE, and 46% are on the tech heavy Nasdaq. As the chart below shows, the Nasdaq has fallen by more than 10% since its peak in mid-July. This is called a “correction”.



The key issue is whether this is a “normal” bull market correction or will we see a more meaningful drawdown. Volatility will likely now remain elevated for some time, as the fear remains that we are at a tipping point in the US economy, and the global economy more generally.

While market volatility creates anxiety, it is important to realize that stock market downturns and corrections occur during any market bull run. Since the start of the year the Nasdaq is up more than 8%, the Australian and other global markets are all positive for the year and are up as much as 15% for the previous 12 months.

As investors, it is important to stay disciplined and trust your well-diversified portfolio. In times like this it is important to remember your long-term financial goals and stay true to your risk profile. Investors should always focus on their long-term financial objectives, especially during periods of financial anxiety.

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