Global Market Turmoil: Behind Stocks' Late Summer Swoon

August 2015 turned out to be the cruelest month in years for stock markets around the globe as persistent uncertainty -- both about the future of China's economy and the timing of the Federal Reserve's long awaited interest rate hike -- took its toll on investor mettle.

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The August Rout

Downward volatility gripped virtually all major global markets, indicating once again how interrelated the world's economies and investment markets have become. The broad-based Standard & Poor's 500 index dropped 6.3% for the month, according to preliminary data released by S&P Dow Jones Indices, making August its worst month in more than three years. The blue-chip Dow Jones Industrial Average lost 6.6% in August -- its worst showing since 2010. And the technology-heavy NASDAQ Composite Index tumbled 6.9% for the month.[1] Outside the U.S., the Stoxx Europe 600 had its largest one-month drop in four years, while the Shanghai Composite continued its third straight month of declines.[2]

Ongoing worries continue to weigh on the world financial markets, demonstrating that the turbulent period for stocks may linger indefinitely.

The Immediate Concern: Federal Reserve Policy Moves

The biggest cause of market angst in the short term is speculation about whether the Federal Reserve will begin raising short-term interest rates this year -- possibly as soon as September 16 or 17 when the policymakers next convene. While the current, widespread bout of volatility may give the Fed reason to rethink its policy moves, its mandate is to stay focused on the broader economic picture. From that perspective, U.S. economic growth has been stable and improving over the past few years.

The much anticipated August jobs report, released on September 4, only furthered the challenging decision awaiting the Fed. The report -- the final major piece of economic data to be released before the September meeting -- offered a mixed bag of news on the jobs front. While the economy added only 173,000 new jobs -- far below the 220,000 that economists had anticipated -- unemployment fell to 5.1%, its lowest level since 2008.[3]

Even within the Fed, opinion is divided on the issue of when to raise interest rates. At its annual meeting on August 29 and 30, Federal Reserve vice chairman Stanley

Fischer said there was a "pretty strong case" for raising rates at the upcoming September meeting. That message conflicted with New York Federal Reserve president William Dudley's earlier comments, which said the case for a September rate hike has become "less compelling" following the recent market turbulence.[1] For her part, Fed chairwoman Janet Yellen has been consistent in her message that the Fed intends to reduce its long-running stimulus program and slowly raise the benchmark interest rate over the next several years.

Bottom line on the Fed and interest rates: Stay tuned and expect the markets to react in the short term, regardless of the outcome of the September meeting.

The Bigger Picture: China's Economic Woes

Another, much more complex uncertainty that is contributing to global market volatility is the tenuous state of the Chinese economy. Recent disappointing economic data coupled with the government's devaluation of its currency have only heightened anxiety among investors, as well as industrial and commodity multinational corporations, which have pegged their corporate strategies and profit projections around China's once "sure-thing" status.

For instance, Caterpillar saw its sales of construction equipment in China drop by half in the first six months of 2015. General Motors and Ford have been shipping fewer cars to China. Weaker Chinese imports of soybeans and minerals have had a sweeping impact throughout Latin America. And the opaque manner in which Chinese leaders are addressing the country's economic challenges make it next to impossible for global economists to forecast China's growth.[4]

Certainly the world's second-largest economy will continue to be a formidable presence on the global economic stage, but the realization that its growth is slowing is requiring investors, companies, and especially the Chinese government to reassess their expectations going forward.

Five Investing Strategies for a Volatile Market

For long-term investors, dealing with volatile markets can be taxing. Here are some points you may want to consider while riding out the storm. None of these should be new to you, but they are particularly important in a volatile environment, which is where their true value is realized.

1. Don't panic -- When markets become volatile, the gut reaction for most of us is to panic -- to buy when everyone else is buying (and when prices are high) -- and panic sell on the downside (when prices are depressed). Panic selling also runs the risk of missing the market's best-performing days. Consider, for example, that missing just the five top-performing days of the 20-year period from July 1, 1995, through June 30, 2015, would have cost you $21,780 based on an original investment of $10,000 in the S&P 500. Missing the top 20 days would have reduced your average annual return from 9.79% to 3.58%.[5]

2. Take advantage of asset allocation -- During volatile times, riskier asset classes such as stocks tend to fluctuate more, while lower-risk assets such as bonds or cash tend to be more stable. By allocating your investments among these different asset classes, you can help smooth out the short-term ups and downs.

3. Diversify, diversify, diversify -- In addition to diversifying your portfolio by asset class, you should also diversify by sector, size (market cap), and style (e.g., growth versus value). Why? Because different sectors, sizes, and styles take turns outperforming one another. By diversifying your holdings according to these parameters, you can potentially smooth out short-term performance fluctuations and mitigate the impact of shifting economic conditions on your portfolio.

4. Keep a long-term perspective -- It is all too easy to get caught up in the stock market's daily roller-coaster ride -- especially when markets turn choppy. This type of behavior is natural, but can easily lead to bad decisions. History shows that holding stocks for longer periods has resulted in a much lower chance of losing money. For example, from January 1, 1926, through June 30, 2015, stocks have never had a period of 20 years or longer where returns were negative.[5] The lesson here? Don't get caught up in day-to-day or even week-to-week variations in stock movements in either direction. Instead, focus on whether your long-term performance objectives, i.e., your average returns over time, are meeting your goals.

5. Consult with a financial advisor. He or she can help you develop a long-term investment strategy and can help you put short-term events in perspective.

No one is certain what impact current drivers of volatility will ultimately have on the economy and financial markets. But as an investor, time may be your best ally. Consider using it to your advantage by sticking to your plan and focusing on the future.

[1]*USA Today*, "S&P 500 posts biggest monthly loss in more than 3 years," August 31, 2015.
[2]*The Wall Street Journal*, "Stocks Tumble on Weak Chinese Data," September 1, 2015.
[3]*The New York Times*, "Slower Job Growth May Give Fed Pause on Raising Rates," September 4, 2015.
[4]*The New York Times*, "China Falters and the Global Economy Is Forced to Adapt," August 26, 2015.
[5]ChartSource®, Wealth Management Systems Inc. For the periods indicated. Stocks are represented by the total returns of Standard & Poor's Composite Index of 500 Stocks, an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. Past performance is not a guarantee of future results. Copyright © 2015, Wealth Management Systems Inc. All rights reserved. Not responsible for any errors or omissions.