CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Speculative Trading is Only One Reason Why Market Volatility is High

- Stocks continue to be volatile on concerns around speculative trading.
- This is just one reason why we have anticipated an increase in market fluctuations.
- Potential market declines may be limited due to stimulus and improved vaccination prospects.

U.S. equities continued their roller-coaster ride today on concerns around speculative trading by retail investors. Recently, the stock market has been led by stocks with the highest percentage of short interests, or investors betting against them. As a reminder, short selling is when an investor borrows shares and immediately sells them hoping to buy them back later at a lower price. If an investor can borrow and sell a stock at a cheaper price than they bought it, they can profit. The fear for financial markets is that if the heavily shorted companies continue to rise in such a volatile fashion, it causes a short squeeze forcing hedge funds and other investors who bet against these companies to sell other securities to raise cash for margin requirements needed to borrow stocks. A short squeeze happens when a group of investors, looking to cover their short positions, start buying at the same time. This has been the primary driver in the performance of these stocks which have large short interests. These forced sales by hedge funds, combined with fears this speculative mania may be an indication of a larger market bubble that it is unraveling, could also cause significant market turbulence.

While recent news has focused on the sharp price moves of companies targeted by speculative trading, as we noted in our 2021 Market Outlook, we continue to expect increased market volatility for many reasons. We feel that the slowly recovering labor market and struggling services side of the economy will keep this economic recovery uneven in the near-term. Until we transition from this economic choppiness to the broader recovery that we expect later this year, market volatility will remain elevated. Further contributing to increasing market volatility include extreme market bullishness, which is historically a contrarian indicator, high valuations, which require absolute perfection in economic output and earnings, slowing positive economic data surprises, and uncertainty about the size and direction of a coronavirus relief package given recent pressure from a bipartisan group of budget-conscious senators.

Overall, in our opinion, the stock market is ultimately grounded by fundamentals and reversions can be very painful to both the upside and the downside. As such, recent market happenings increase the potential for a market correction or at least sideways movement for some time. While a market correction is possible, keep in mind that they are not as alarming as the name suggests. In general, a market correction is a stock market decline that is more than 10 percent from highs. In the imminent future, we do not foresee a more serious bear market where stocks fall 20 percent or more from their highs. Significant fiscal and monetary stimulus, along with increased vaccinations, should offer near-term downside protection.

Markets continue to follow our 2021 blueprint that includes increased levels of market volatility. In these times, your financial professional can help you stay focused on your long-term risk and return goals and help you with your personalized investment objectives.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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