Volatility set to return to markets

HOT PROPERTY

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Volatile markets are characterised by wide price fluctuations and large trading volumes. Photo: Peter Braig

A lot has been written about financial market volatility and the impact on investor sentiment. Volatile markets are characterised by wide price fluctuations and large trading volumes.

Simply put, volatility is the amount of price change experienced over a given period.

Low volatility means that a security's value does not fluctuate dramatically, but changes in value at a steady pace over a period of time. If the price fluctuates frequently, it is said to have a high volatility.

Physical property has been labelled a low volatile asset, primarily because it does not trade frequently. On the other hand, listed Australian real estate securities (A-REITs) can be bought and sold daily on the ASX.

However, with that level of liquidity comes an increase in the prospect of price volatility.

Notwithstanding, over time, the A-REIT sector has been considered to have a lower volatility than that of the general equity market.

That is, until the GFC came in 2007-2008. Before the GFC, the A-REIT sector, as measured by the S&P/ASX 300 A-REIT Index, was considered to have a low level of volatility. Over the calendar years between 2000 and 2006, this index, on average, rose or fell by more than 3 per cent per month on four months per year and only one month per year did it rise or fall by greater than 5 per cent.

In 2007, we saw the index record eight monthly moves greater than 3 per cent, of which three months recorded moves of greater than 5 per cent.

This level of volatility was surpassed in 2008 when the index recorded 10 out of 12 monthly moves greater than 3 per cent (one rise and nine falls) of which eight months (all falls) recorded moves greater than 5 per cent. Since 2008, the A-REIT sector has averaged five monthly moves greater than 3 per cent per year and three moves greater than 5 per cent per year.

While the underlying real estate markets are robust, with the exception of retail, which is struggling due to cyclical and structural factors, and the underlying earnings of the A-REITs are in good shape, we may see A-REIT prices being more driven by capital market factors that have nothing to do with the underlying real estate.

In such an environment, we expect volatility to return to the market. Already the first two months of this year have seen the sector record monthly moves greater than 3 per cent, with January recording a fall of 3.3 per cent and February recording a fall of 3.9 per cent.

We now wait and see how the rest of this year pans out. Of course, with volatility comes opportunities to take advantage of swings and roundabouts that prevail due to the wide price fluctuations that occur.

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