Understanding Volatility: What causes volatility and how to spot the signs?

Understanding how different events affect volatility can help you better understand the long term and short-term movements of company share prices.

Let's look at the types of events that can trigger volatility.

1. Supply chain disruptions

Events such as natural disasters, pandemics, or geopolitical tensions can cause significant supply chain disruptions which can lead to severe share price volatility. The COVID-19 pandemic is as a prime example of an extensive supply chain disruption. Industries such as travel, hospitality, and manufacturing faced unprecedented challenges, with the Qantas share price falling by 52% in just two months. But not all the news was negative. The semiconductor industry experienced severe shortages due to factory shutdowns. The limited supply caused stock prices in certain technology companies to surge. For example, leading Taiwanese semiconductor manufacturer TMSC's share price reached an all-time high in 2021 due to increased demand.

2. Geopolitical events

Global events such as elections, trade agreements, or conflicts can introduce uncertainty and volatility into financial markets. The recent US-China trade tariff war is a good example of a geopolitical event that caused industry-specific volatility. The US technology sector, which relies heavily on China for production, was severely impacted, with the technology index (NASDAQ) falling 15% in the weeks following President Trump's tariff announcements.

2. Regulatory changes

Industries are often subject to regulations or government policies that can impact operations. Sudden changes in regulations can introduce volatility in sectors heavily reliant on compliance. One example is the impact of the Australian Banking Royal Commission in 2019. The release of the final report led to significant volatility in the share prices of major Australian banks due to the potential of increased compliance cost and changes to business models, with the price of Commonwealth Bank (CBA) shares falling close to 7% in one week.

3. Technological innovations

Rapid technological advancements can disrupt entire industries by changing how products are made or delivered. Companies that fail to adapt may face a sharp decline in market share, leading to increased volatility in their stock prices. Companies that can innovate often benefit. The rise and subsequent fluctuations of electrical vehicles (EVs) driven by battery technology is a good example. Tesla's stock price surged over 700% in 2020, making it one of the most valuable automakers in the world, surpassing giants like General Motors.

4. Market sentiment and consumer behaviour

Changes in consumer preferences, often influenced by social trends, technology or economic conditions, can lead to volatility in industries such as retail and consumer goods. One notable example is Nokia. At one point Nokia was the world's largest mobile phone manufacturer. However, as consumer preferences shifted to smart phones, Nokia was unable to compete, resulting in a fall of 92% in the company's share price and their eventual acquisition by Microsoft.

5. Natural disasters

Natural disasters, such as hurricanes or earthquakes, can cause abrupt share price volatility. The aftermath of the Australian bushfires of 2019-20 exemplifies this, particularly in the insurance and building sectors. QBE Insurance, one of Australia's largest insurers, saw its share price decrease by

21% in the months following the fires due to concerns about a rise in insurance claims. Boral, a major construction company, saw its share price rise in 2020 as the rebuilding efforts gained momentum.

6. Earnings reports

Earnings announcements often lead to increased volatility, as investors react to the results compared to market expectations. Stocks can experience significant price movements in the days following earnings report announcements, due to changes in earnings forecasts, guidance, or sentiment. For example, when Netflix released its Q1 earnings report in 2022 the company surprised the market by announcing that subscriber numbers had fallen for the first time in 10 years. The share price dropped 25% in one day.

7. Monetary policy announcements

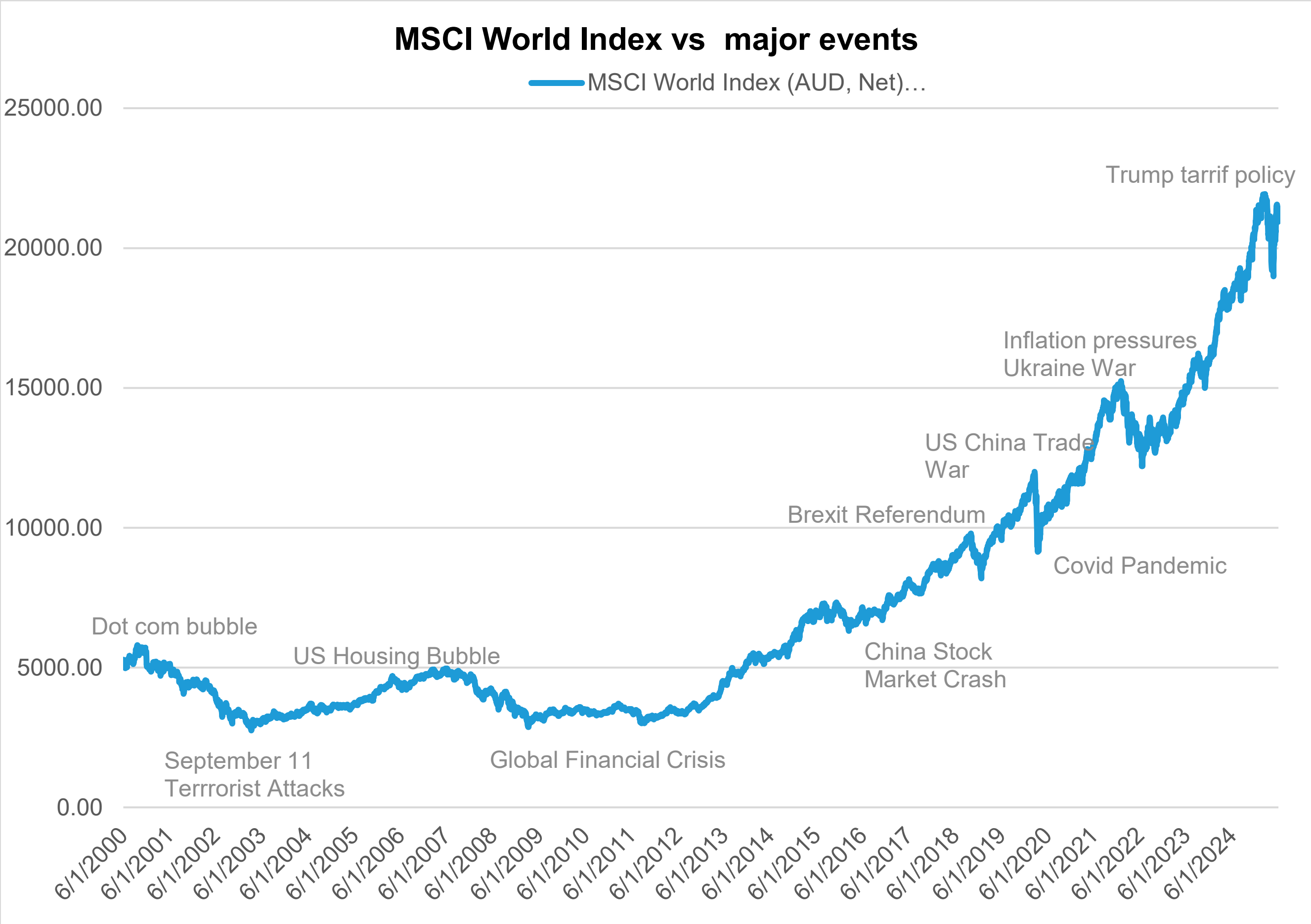
Changes in interest rates and monetary policy can drive significant volatility in the markets. Investors should be particularly attentive to Central Bank announcements, as these can result in rapid price movements across various asset classes.

8. Sector sensitivity to economic cycles

Some industries are more sensitive to economic cycles than others. For example, consumer discretionary sectors, such as retail, tend to be more volatile during economic downturns compared to consumer staples, which generally remain stable as they provide essential goods.

Chart 1 illustrates the persistent nature of the equities market which has historically recovered to new record highs following short- and long-term bouts of volatility caused by a range of factors including regulatory change, tech innovations, geopolitical events and natural disasters.

CHART 1



Source: AB 2025

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Ask your adviser for more information on AB's range of strategies that are designed to deliver strong long-term returns by reducing the impact of market volatility.