Fear of a second dip came back to the markets…

High volatility still in force for the markets...

After the S&P cut the long-term US rating by one notch to AA+ with a negative outlook, citing concerns about budget deficits, the global markets dove in the first week of August. The sell-off accelerated in the global market due to increasing fear that the Eurozone debt crisis will spread to Italy and Spain and the European Central Bank bought Italian and Spanish government bonds. In addition, rumors in France, which is the second largest economy in Eurozone would also lose its AAA status caused an acceleration in the sell-off.

New steps from central banks falling short…

The decision of European Central Bank buying Italian and Spanish government bonds together with the Fed's signal in its last meeting that it would remain on hold through mid-2013 helped calm investors for a short term, after after the S&P cut the long-term US rating. But concerns on the EU debt crisis and slowing US economy are still on the table.

CBRT cut the benchmark 50 bps to 5.75%…

The CBRT cut the policy rate (1-week repo rate) from 6.25% to 5.75% in a surprising move, accompanied by an increase in the O/N borrowing rate to 5.0% from 1.5% parallel to our forecast and broadly in line with the market consensus. In its one-page announcement, the bank stated that it aims at diminishing stagnation risks in economic activity by cutting the policy rate. On the other hand, the MPC hiked the O/N borrowing rate with the aim of decreasing downward volatility in the O/N market by narrowing the O/N rate corridor by 350 bps. With this move, the aim is to attract short-term inflows to facilitate the financing of the record current account deficit, in our view. The MPC kept the policy rate unchanged at (5.75%) in its August 23rd meeting, as expected.

Sell-off deepened in global markets, including the ISE…

Global markets, including the ISE, faced strong sell-offs amid great volatility due to the increasing concerns about EU's debt crisis combined with US' rating cut by S&P. Also, recent macro data releases indicating a global slowdown gave added credence to the sell-off mood.

Reactionary buybacks may occur in September following the strong sell-off in August, however we believe that volatility will continue in the markets due to the fears on the Eurozone debt crisis and talks on double dip in the US. On the domestic front, ongoing tension in the FX market stemming mainly from C/A concerns still keep the TL under pressure which also affects the mood negatively on stocks.

Our portfolio recommendations for September 2011

We maintain our portfolio coverage of 40% in government securities, 20% in FX and 40% in equities.