

Addressing Volatility in the UK Stock Market: Problems and Solutions

Zixu Wang *

Faculty of Natural, Mathematical & Engineering Sciences, King's College London, London, The United Kingdom

* Corresponding Author Email: K22019534@kcl.ac.uk

Abstract. The UK financial market is the core of global capital flows, bringing together global investors and traders, with a grand scale and continuous innovation. Its sound regulatory system ensures market stability, has a significant impact on the global economy, and is a key force driving global economic development. However, it faces challenges such as market volatility, information asymmetry, liquidity issues, and adapting to new trends. These challenges test the stability and growth of the market. To address these challenges, this article provides a detailed analysis of their root causes and proposes a series of solutions and strategies to promote market stability and growth. The focus of this article's analysis is to improve market transparency, alleviate market volatility through risk management tools, reduce information asymmetry through fair sharing of information, enhance market liquidity, and enhance the market's ability to resist emerging dynamics. Implementing these strategies can alleviate market instability and information imbalance, thereby improving market efficiency and stability in the short and long term.

Keywords: Financial system; UK; stock market.

1. Introduction

Financial markets play a crucial role in modern economies by facilitating capital allocation, wealth creation, and economic stability. Their evolution and globalization have made them integral to the functioning of the global economy. As technology continues to reshape these markets and new challenges emerge, it is essential to recognize the paramount importance of financial markets in shaping our economic future [1]. The London Stock Exchange, as a long-established and influential part of the global financial system, has demonstrated its unique character and maturity of development. It attracts companies and investors from all over the world and has become a significant platform for international investment. With a reported population of 67 million and a GDP of \$3.1 trillion, the UK remains Europe's second-largest economy in 2022 and leads the G7 with a GDP growth rate of 4.0%. Despite regulatory challenges resulting from Brexit, high inflation due to rising energy prices, and the impact of the COVID-19 pandemic, the UK remains an important market for US exports of goods and services. In 2022, US exports to the UK reached \$157.1 billion, a year-on-year increase of 21.5 percent. However, the UK still faces several challenges and issues despite its favourable market development. Prominent current issues include market volatility, information asymmetry, and liquidity issues.

2. Problem

2.1. Market Volatility

The TSE 100 Index is a crucial stock market index in the UK that reflects the performance of the largest listed companies. Its volatility is influenced by various domestic and international factors, including political events such as the UK's exit from the European Union, global economic conditions such as trade tensions, and unforeseen events like epidemics. Volatility factors pose high risks to traders and challenge the price discovery mechanism of the market. Price discovery mechanisms are fundamental to the healthy functioning of markets and rely on the effective flow of information and market participants' expectations of future price movements. However, in situations of high

uncertainty in the market, the pound sterling saw dramatic fluctuations, UK share prices underperformed against major peers, and business investment stagnated. Additionally, Brexit induced a "Brexit premium" in borrowing costs for British companies and weakened the UK's financial position, with soaring debt levels and a large current account deficit [2]. This can affect the long-term stability and efficiency of the market and increase the market risk faced by investors. It is important to maintain a balanced approach to market analysis and avoid biased language, as high volatility not only increases trading risks but also challenges the market's price discovery mechanisms.

2.2. Information Asymmetry

The issue of information asymmetry is a significant concern in the UK FTSE 100 index futures market. This market is characterised by notable differences in the ability to access and process information among its participants, particularly between small investors and large institutional investors. It has been observed that in cases of severe selling pressure, the most significant consequence of an asymmetric liquidity scenario is that sell orders may not be filled at all, rather than being filled eventually. When high selling pressure is combined with low bid depth, sellers are forced to sell at prices closer to bids and with less waiting time [3]. Large institutional investors can make trading decisions quickly in response to the latest market developments by using advanced analytical tools and algorithms, as well as having access to a wide range of research resources. This ability is based on their processing of instantaneous data and in-depth analyses of deeper market trends and potential influences. In contrast, smaller investors usually struggle to access and analyse timely and critical market information. They often rely on publicly available sources, such as financial news, public market data, and social media. These sources tend to be more delayed and lack depth and breadth compared to the advanced analytical tools and professional research reports used by large institutional investors.

2.3. Market Liquidity

In the UK stock index futures market, liquidity is particularly crucial during times of increased market volatility or uncertainty. Liquidity refers to the ability of assets to be bought and sold quickly without affecting their price and is a key indicator of the financial market's health. High liquidity in major stock index futures, such as the FTSE 100, enables investors to enter and exit the market efficiently, while maintaining reasonable transaction costs.

Recent global events, including the UK's exit from the European Union, the COVID-19 outbreak, and other geopolitical factors, have significantly affected the market. For instance, the uncertainty surrounding the UK's departure from the European Union resulted in significant volatility in the FTSE 100 during the latter stages of the referendum. This political uncertainty caused market participants to become more cautious, potentially leading to fund withdrawals and a wait-and-see approach from potential buyers and sellers. As a result, immediate trading activities and market liquidity decreased. The virus has a major impact on the UK's economic activities. It has particularly affected the stock market which is visible from the share prices. These prices let everyone see how different industries are impacted by the virus in real-time [4]. Especially during the initial stages of the epidemic, numerous investors opted to withdraw their capital or reduce trading due to increasing uncertainty and panic. This resulted in a shortage of liquidity in the market.

2.4. Market Adaptability

The UK stock index futures market is facing the challenge of adapting to emerging market dynamics due to the structure of the global economy and the rapid development of technological innovation. The rise of the digital economy and the growing importance of technology and innovation companies in the stock market have significantly impacted traditional stock indices such as the FTSE 100. For instance, technology giants are expanding at a faster rate than many traditional sectors. This has not only altered the leadership landscape of the stock market but has also significantly impacted investment strategies in the futures market. Disruption poses a significant threat to all companies, but

it also presents a great opportunity. Companies that comprehend the possibilities of the future can capitalize on the positive aspects of disruption by developing a continuous transformation strategy that balances transformation initiatives across three horizons: the present, the near future, and the distant future. Companies that manage transformation in this way can establish a solid foundation to support future growth, enable new value propositions, and explore entirely new businesses or 'game changers' beyond [5]. Given the emerging trends, participants in the UK equity index futures market require flexible investment strategies and tools to capitalise on growth opportunities in emerging sectors.

3. Solutions

3.1. Mitigating Market Volatility

Regulators and market operators can improve market transparency by providing more information on market dynamics and trading activities. This includes real-time dissemination of market data, trading volumes, and statistical information on price movements. Increased transparency can help market participants better understand market trends and make more informed trading decisions. Furthermore, investors can introduce or optimize risk management tools, such as derivatives like contracts for difference (CFDs), options, and futures, to hedge their risks and protect their investments against extreme market volatility. For instance, by using FTSE 100 options, investors can establish a future buy or sell price, limiting potential losses due to market volatility. Effective risk management involves not only measuring risk but also setting limits and constraints to mitigate it. Institutions can manage risk exposures within manageable boundaries by using risk budgeting, position limits, scenario limits, stop-loss limits, and capital allocation to define these constraints. This ensures that their risk-taking remains aligned with their risk appetite [6]. These risk management tools, along with improved market transparency, form the fundamental strategy for reducing the impact of market volatility.

3.2. Reducing Information Asymmetry

Measures to enhance the impartiality of information can be implemented to guarantee that all market participants have access to crucial market information. This involves requiring listed companies and exchanges to disclose important financial information and market data, as well as ensuring that such information is released promptly and in a comprehensible format. Regulators can oversee and regulate high-frequency trading activities to prevent any unfair advantage gained through high-speed trading. Regulating high-frequency trading can promote fairness in the market and prevent a few participants from dominating due to technological advantages. Additionally, implementing blockchain technology to establish a decentralised trading and information sharing system can further enhance market transparency and security. Using distributed and autonomous systems, cognitive enhancement systems, computer vision algorithms, transaction data and business intelligence analysis, blockchain technology can support transparent citizen participation through immutable ledgers and thorough transparency [7]. The use of blockchain technology guarantees that all transaction records are public and tamper-proof. This ensures that all market participants, regardless of their size, have access to the same reliable information and are therefore on an equal footing when making trading decisions.

3.3. Improving Market Liquidity

Exchanges and regulators can take several measures to improve market liquidity. One key step is the introduction of a market maker system. This system encourages selected financial institutions to act as market makers and provide continuous bid and offer quotations. As a result, the liquidity of the stock index futures market can be significantly enhanced, allowing investors to quickly buy or sell their positions at any time. In order to mitigate the impact on market liquidity, the withdrawal of market makers provides opportunities for other participants to act as liquidity providers. However,

how these alternative liquidity providers perform in stressed markets is uncertain. New liquidity providers, lacking access to ancillary revenues from their clients, may have less incentive to support market liquidity in stressed conditions. However, a wider range of liquidity providers could have a positive impact on the reliability of supply, particularly in the case of electronic trading. Nevertheless, for the foreseeable future, dealers will remain the primary providers of liquidity in fixed income markets. As a result, to help market makers cover their operating costs, bid-ask spreads for illiquid assets such as corporate bonds are likely to widen over time. In a favourable scenario, bid-ask spreads and other measures of liquidity would more closely reflect actual market-making capacity and costs, reducing the risks associated with a "liquidity illusion". However, as recent episodes of heightened bond market volatility have shown, the transition to such a market environment can lead to strained market conditions [8]. Secondly, improving market transparency is equally crucial in boosting investor confidence and encouraging market participation. Making trading information and market data publicly available in a timely manner enables investors to gain the necessary market insights to make more informed investment decisions. This increased confidence can incentivise more participants to enter the market, thereby improving overall market liquidity. Finally, the development and promotion of more financial derivative products, such as stock index options, provides investors with a wider range of trading options and risk management tools. By providing investors with diversified investment tools, more trading activities can be facilitated, thereby enhancing overall market liquidity.

3.4. Improving Market Resilience to Emerging Dynamics

Innovation is a constant force within the financial system, which can be disruptive but is fundamentally neutral. It has the potential to expand financial options and improve lives, but it can also cause significant harm to consumers. There is often a lack of clarity among market participants about how consumer protection and other rules apply to new products and services, which can lead to negative outcomes for consumers. Regulators have a legal mandate to set and enforce market rules, balancing priorities such as market growth, transparency, competition, stability and security to minimise turbulence and risk while enabling necessary progress [9]. Exchanges and regulators should continuously update and adjust market rules and products. One way to achieve this is by regularly reviewing and adjusting the composition of stock indices to ensure they accurately reflect the current state of the market and the economy. Additionally, the development and introduction of new financial derivative products, particularly those that cover emerging industries and technologies, can help investors diversify their risks and seize investment opportunities. Finally, improving cooperation and information exchange with international markets is crucial for enhancing the global competitiveness of the UK stock index futures market. The United Kingdom (UK) has been a prominent global financial centre for many years, serving as a hub for a large number of organised financial and securities markets around the world. However, international investors in UK equity markets have become increasingly concerned about recent adverse economic events, such as the prolonged US-China trade war and the novel coronavirus (COVID-19). However, recent negative economic events, such as the ongoing trade war between the US and China and the new coronavirus COVID-19, are causing increasing concern among international investors in UK equity markets. Although these events did not originate in the UK, they have had a significant impact on the UK stock market. Financial markets have been adversely affected by the recent economic downturn. Global equities have been volatile, experiencing significant falls and spikes, with the FTSE100 triggering circuit breakers on several occasions. This negative sentiment in the global financial market is undoubtedly disruptive to the business cycles of UK companies [10]. By cooperating with exchanges in other countries and regions and sharing market data and information on investment trends, the UK market can more effectively anticipate and respond to changes in the global market. This, in turn, helps to develop more effective market strategies and decisions, improve market transparency, and promote global investors' confidence and participation in the UK market.

4. Conclusion

This article emphasises the significance of researching the UK stock market, specifically the London Stock Exchange, and the measures taken to maintain market stability and growth amidst present challenges. By examining concerns such as market volatility, information asymmetry, liquidity issues, and the market's ability to adapt to emerging dynamics, several solutions and strategies are suggested. Improving market transparency, mitigating market volatility through the use of risk management tools, reducing information asymmetry through equitable sharing of information, improving market liquidity, and enhancing market resilience are all important strategies. These strategies not only help to mitigate short-term market volatility and information asymmetry, but also improve the long-term efficiency and stability of the market. Furthermore, the effective execution of these strategies necessitates collaboration among regulators, market participants, and technological innovators. This is the only way for the UK stock market to sustain its prominent position in the global economic system, entice more international investment, and stimulate economic growth.

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