
Circuit Breakers and Dimensional's Approach to Trading

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Recently, several markets, including in the US and Brazil, have hit circuit breakers, where trading is paused for a period after a specified percentage decline in the market. In all cases, trading resumed as planned. Circuit breakers can serve a useful function: they mandate a short halt during which participants can assess new information and calibrate their trading activity.

While market volatility has triggered these rarely used rules, markets have been functioning as expected, given the recent news. Both the bond and equity markets have had increased trading volumes, bid-offer spreads, and volatility. Despite this, Dimensional has continued to manage strategies efficiently and in a manner consistent with their investment guidelines.

Our investment process is designed to function robustly and account for changes in security prices, changes in available liquidity, and sharp market movements. During a trading day, it has long been part of our trading process to allow for flexibility in the timing of when to trade. For example, Dimensional may choose to pause trading around an event that could result in unusual volume or volatility, like a company earnings announcement, an index reconstitution, the release of economic data, or a development in the news.

This longstanding flexibility can be valuable when volatility is high. If needed, we can sit out the early moments after the stock markets open and overnight news is being priced in. We can also use this flexibility to plan for circuit breakers.

As we approach each trading day in each market, we consider news releases, activity in other markets, the performance of overnight stock futures, and other factors. Those evaluations may lead Dimensional to anticipate that index performance will result in a circuit breaker being triggered, which can lead to higher bid-offer spreads and other potential implicit trading costs. This information is available to portfolio managers and traders before a market opens and can be used to implement strategies as efficiently as possible. In such instances, our research¹ has shown that a flexible trading approach tended to add more value when compared to an approach that requires immediacy.

Dimensional will continue to monitor markets closely. Our investment approach allows us to remain consistent in how we manage our clients' assets through the market's ups and downs.

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1. Dave Twardowski and Ryan J. Wiley, "Global Trading Advantages of Flexible Equity Portfolios" (white paper, Dimensional Fund Advisors, 2014).
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