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Graham Bentley offers some reasons to be positive amid the gloom.

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beyond the 'doom-boom'

As I write this, a snow blizzard is blowing outside for the second day, and seemingly London and the South East has slid to a halt. Early estimates by the Federation of Small Businesses suggest it will cost the economy over £1.2 billion in lost business¹. When it rains it, er, snows.

Depressed? If the press and TV are to be believed, you should be. People are losing their jobs, homes and in some tragic cases, their lives. The recession upon us is being described as the deepest in our lifetimes, despite the fact that we are only six months into it.

If you are 65, you will have suffered five recessions in your working life: 1961 (six months), 1973 (nine months), 1975 (six months) 1980 (15 months) and 1990 (15 months). 1990 is often cited as the deepest recession of recent times, when the economy contracted by 2.6%. However, between 1979 and 1981 the economy shrank by over 5%.

The recession of 2008 is six months old as we speak and GDP has fallen by a little over 2%. So why the intense gloom? Well, for starters this recession and associated job losses appear to be global. Voters the world over are protesting, if not striking (withdrawing labour being a somewhat perverse response to, well, the withdrawal of labour). According to the FT², even

Labour MPs are despairing. 'They're looking at what they will do after the next election', according to Ian Gibson, Labour MP for Norwich North. Presumably they won't go into banking. Another consideration is simply human nature; it is easier to be gloomy than positive. As author and activist Peter McWilliams noted, 'the news media are for the most part, bringers of bad news ... bad news gets higher ratings and sells more papers than good news'.

positive indicators

What are the statistics that underlie the news stories telling us? A useful guide to the state of world economic activity is to look at the trade in basic materials (hence an indicator of economic growth), and one measure of this is the Baltic Dry Index (BDIY). The Baltic Exchange in London is the centre of the bulk freight market, and it publishes a daily index to show the change in shipping costs for a variety of cargoes of raw materials. On 20 May 2008, the BDIY hit an all-time high. Charter rates for the largest ships were \$234,000 per day two weeks later. By the beginning of December, rates had fallen by 94% over 2008. Those levels were very near the

actual running cost of the ships, crew, and fuel. The good news, virtually unreported, is those rates have risen from less than \$3,000 per day to approaching \$14,000³. The BDIY has risen from its December low of 663 to 1099 as at 2 February 2009⁴.

what about stock markets?

January 2009 was the worst opening month in US market history, with both the DJIA and S&P 500 down over 11% in dollar terms.

However, a less well reported statistic concerns volatility. The Chicago Board Options Exchange calculates volatility indices, the most important of which reflects activity on the S&P 500; the higher the index, the more volatile the market. In October 2008, the index rose from the mid-teens range it had traded in for years, to almost 90 – its highest ever level. This was widely used as an indicator of the end of life as we knew it. Somewhat quietly, the index has fallen 50% since then – in other words, volatility (or risk) has halved.

fundamental truths

Response to the circulating news is almost universally negative. Falling output makes many people fear for their financial futures. We react to falling house prices as a contraction in our personal wealth, as opposed to recognition that a house is a home first, for all but the buy-to-let market. We are pained by reports of corporate closures and associated redundancies, until we reflect that while vacancies have fallen dramatically during 2008, some 530,000 remain unfilled. While unrealistic or insensitive positivity is less than helpful

(a recent cover of Top Gear magazine boldly pronounced ‘Screw the economy, let’s race!’), when it comes to investing it is helpful to remind ourselves of some of the ‘golden rules’⁵:

- *Don’t let the headlines scare you out of investing your clients’ capital. You are the pilot on your clients’ trip to retirement and beyond. Maintain the flight-plan through recessions, corrections, and bear markets.*
- *Don’t try to time the market. Getting out is less than half the process. When to go back in again is the harder decision. You will likely as not miss important gains.*
- *Deciding how to allocate clients’ capital across asset classes is fundamental to your planning. Choosing the right fund is a secondary consideration. Academic studies have shown that over 90% of the difference between one portfolio’s performance and another’s is explained by asset allocation. How you divide your portfolio between Equities, Fixed Interest and Cash is critical. Using risk assessment processes and asset allocation tools will help find the mix that fits a client’s tolerance of risk,*

matched to your ‘flight plan’. Once you’ve made that crucial decision, choose your specific investments and stick to your plan.

- *History tells us that share prices decline going into a recession, then recover before the economy at large has recovered. The reason they recover early is that some investors anticipate an upturn in corporate earnings, and start buying more shares at relatively depressed prices. The potential for higher earnings in the future makes shares more valuable, as investors are willing to pay higher prices for those earnings.*

During recessions, bad news is accentuated, we worry more, and the more share prices fall, the louder the ‘doom-boom’. Everyone will tell you how bad things are, but look for the silver linings; stick with your plan, and don’t quit. ●●

1. Bloomberg.com 2 February 2009, Federation of Small Businesses.
2. Financial Times, 31 January 2009/1 February 2009 p9.
3. Metal Bulletin Iron Ore Index, 19 January 2009.
4. Bloomberg.com, 2 February 2009.
5. Adapted from ‘Peter Lynch’s Investment Test’, Business Week, 9 November 1998.

“ a positive attitude may not solve all your problems, but it will annoy enough people to make it worth the effort ”

Herm Albright

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