SVM
HAWK-EYED STOCKPICKERS

for financial advisers only

staying on track

May 2008

Colin McLean, Managing Director, SVM Asset Management,
explains why market volatility need not mean a change of strategy for clients with long-term financial planning in place.

As advisers you will know only too well that private investors worry about stock market volatility. While most have a long-term financial plan with no intention of selling this year, they may begin to wonder if the market is trying to tell them something. How can values swing so rapidly within a day's trading? Why do shares seem strangely detached from the relatively stable day-to-day life of the economy? The first quarter of 2008 has triggered an avalanche of analysis and comment from the media, but little of the sound advice investors need.

Few experts can predict stock market corrections or rallies. Indeed, websites like Guru Grades – analysing predictions objectively – highlight the poor records of most forecasters. Many comments are equivocal; offering little clear advice on what should be done and lacking timescale or targets. The rest are mainly plain wrong and investors would do better to look elsewhere for guidance.

long-term planning

Like the stock market experts, advisers are also unlikely to be able to forecast the future, but you will know how your clients' overall financial planning has been structured. You are also likely to have heard from the fund managers themselves just what long-term strategy lies behind the portfolio.

Investors should remind themselves why they hold shares – it is easy to forget this in turbulent times. For those with long-term objectives, the persistence of economic growth and its broadening globally is reassuring. This has been translated into long-term growth of company earnings on average, with dividends growing faster than inflation.

On a timescale of five years or more, stock markets make sense. Indeed, the last 25 years has been a remarkable success story for economic management by central banks, with very few quarters of absolute recession in the US and little lasting damage from occasional over-exuberance in some fast growing emerging market economies. But investors do need to be clear about their own objectives, timescale and tolerance for risk. Everyone should have a long-term plan to help in securing their financial futures – and it would be prudent to ensure that these plans can deal with the impact of changing sentiment on short-term values.

bottom-up approach

Early in 2007, SVM's investment team became concerned about overheating in the US economy and in particular risks within banks. That view was reflected in reduced exposure to the financial sector – a position which we maintain today.

A more fundamental analysis of banks is needed – not just looking at historic prices, reported earnings or dividend yields. A large portion of bank earnings

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Colin McLean studied at the University of Glasgow, where he obtained an MA in Political Economy and Economy Statistics before going on to gain an MBA.

He was deputy managing director of FS Investment Managers from 1974 to 1986 prior to its acquisition by Brittanic. He then became head of investments at Scottish Provident's £2.5 billion funds business until he was headhunted by Templeton in 1988 to be managing director of its European operations. He founded SVM Asset Management with Margaret Lawson and Donald Robertson in 1990.

supporting previous dividend payouts will not be sustained. SVM's approach is one of stock picking, and we do not feel compelled to invest in major banks just because they are large constituents of the Index. The key will be to avoid areas where borrowing is high and we believe that fundamental analysis will continue to guide us away from the greatest risks amongst financials. One response to the significant use of public money in supporting the bank sector is likely to be calls for dividend cuts.

recognising risks

One area of surprising risk is in growth businesses, which are often viewed by investors as a safe haven in market turmoil. Technology and other growth sectors are assumed to be driven more by their own product potential and innovation, and less by overall economic trends. Yet, as we have seen from Wolfson Micro electronics and ARM recently, few businesses are immune to a downturn. Growth businesses often start from a much higher rating, giving them further to fall on a change in sentiment. It is a time to be more focused on values.

identifying opportunities

Despite the immediate negatives for financials and technology, we believe there are many areas of the market that give the opportunity for profit in 2008 and beyond. Utilities can grow dividends faster than inflation, and the RPI itself seems set to stay above 4%. Telecoms also offer attractive cash flows and are strongly represented in our portfolios. Low interest rates and the prospect of further US Dollar weakness should also keep up prices of gold, precious metals, oil and food. These themes, along with identification of a number of businesses that appear materially undervalued relative to trade values or restructuring potential, give us confidence in our portfolios.

Investors should be prepared for the impact of further volatility in their portfolios. While there are usually opportunities to rebalance portfolios to align them with personal tolerance for risk in all types of market, it is important not to try to time markets, as very few will get in at the bottom. A stock market recovery usually develops rapidly when it is clear that conditions are easing for businesses, or valuations are excessively depressed.

Investors should take stock of their portfolios and risk appetite. But stock market volatility itself should not trigger a change in strategy for most savers.

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