



JANUARY 2008

MARKET HAPPENINGS

WHAT A TIME TO TAKE A HOLIDAY

After working a few days over the Christmas/New Year period and returning to open the office on the 7th of January, I thought I would take a few days off, Wednesday the 16th to Wednesday the 23rd, once all the troops had returned by the 21st. My timing could not have been worse! Equity markets tumbled. Some clients have even (jokingly) suggested that it was all my fault for going away, and others, that my timing was either perfect, (if I wanted to hide from it and not be contacted), or lousy, (if they wanted to talk to me).

SO WHAT HAPPENED?

The sub-prime mortgage crisis which began in August, 2007 has widely been acknowledged as being the main catalyst for the current market volatility. The ongoing defaults in US sub-prime mortgages have reduced the amount of credit available worldwide and diminished returns from banks, retailers and construction costs. Investors are concerned that rising interest rates in Australia may slow the economy. Banks are raising mortgage rates because they are paying more to borrow money on debt markets. At the same time, faster inflation in Australia has raised expectations that the Reserve Bank of Australia could increase the cash rate from 6.75% at its next meeting in February. This in turn could strengthen the Australian dollar. Australian stocks declined sharply as global stock markets have been disturbed by disappointing reports about the health of the US economy. The S&P/ASX 200 Index fell as low as 5200 points on Tuesday the 22nd of January, a decline of over 20% from its 2007 highs.

However, the market rebounded strongly on Wednesday – up 4%, Thursday – up 2.6% and again on Friday – up a further 5% to close the week at 5886 points.

It would therefore appear that client's comments, (jokingly) referred to above, about it all being my fault were right. No sooner do I return to the office than the markets start bouncing up again, Oh, If only I had that influence, wouldn't it be wonderful!!

There is some thought that much of the selling that took place on Tuesday the 22nd was driven by calls being made on margin loans (loans secured against share portfolios). As share prices fall, so to does the borrowers equity and the lender will require either an injection of funds to maintain the margin or equity, or that sufficient of the shares be sold and the proceeds applied against the loan to maintain the equity. This will often see investors who have borrowed against their portfolio being forced to sell on a falling market even though they may not wish to do so.

THE OUTLOOK

Volatility will continue throughout 2008 and it is something that investors will have to get used to. Just a few months ago, the Australian share market underwent a similar correction, though that proved to be short lived after the US Federal Reserve came to the party and eased interest rates. That had a positive effect on the global share markets and the same has happened again. The US Federal Reserve has said it is more concerned about stopping their economy slipping into recession than it is about inflation, so more interest rate cuts, if necessary, are not out of the question.

Australia also now has a more independent economy, more linked to a variety of markets, particularly Asia, and our economy is still quite robust. So while a slowdown in the US won't be enough to force Australia into recession, it will take some of the heat out of our economy and potentially leave our interest rates more stable.

IT'S ALL HAPPENED BEFORE

After the terrorist attacks of September 11, US markets stayed closed until September 17. In the five days following the re-opening, the S&P 500 index fell 11.6%. In the warning against short term panic, legendary investor Warren Buffett said: "Whatever you thought about the stock market before the World Trade Centre is what you should be thinking now".

As usual, he was right. By October 15 the S&P 500 was back near their September 10 levels. Investors who panicked simply crystallised losses rather than protecting their capital.

Share markets do react, often sharply, to crisis. Yet they tend to snap back quickly as investors reassess the real economic impact of these events. **We have already seen this happen this time around.** During the Iraq invasion of Kuwait in 1990, the S&P 500 dropped around 5% within a month. Within six months, the market was up almost 16%. Within a year it had leapt 26%.

MESSAGES FOR INVESTORS

- Over the 25 years to 2007 the Australian stock market has delivered a compound return of over 15%. With tremendous returns for investors over the last 4 years (28% in '04, 22% in '05, 25% in '06 and 16% in '07), it is reasonable to expect that returns would eventually return to more normal figures of around 12% over the long term.
- The Australian economy is still quite robust.
- The bounce back is another good example of how it is usually best to stay calm during such dramatic sell-offs. Research shows that over the last 19 years you only had to miss the best 27 days in the share market to reduce your return to that of a cash return; timing share markets is very difficult.
- The big question for investors is: "Is this the start of a prolonged bear market, or have we just seen a dramatic January, with the prospects of reasonable returns for the balance of the year?" Whilst we cannot predict the future, with our strong economy and an aggressive Federal Reserve, reasonable returns are likely from here to the end of the year, with volatile swings on any negative US economic news.

SO WHAT'S THE BEST COURSE OF ACTION

Before making any major changes to your investment strategy, it's important to remember that this is not the first time markets have experienced this sort of activity.

Equally important to remember is that each and every example given above, the market recovered and went on to new, all-time highs – often within a relatively short time. And while nobody can know the future, it is likely that markets will follow a similar pattern this time.

While selling may make you feel more comfortable because it means you won't be exposed to any further losses, it also means that you won't be exposed to any gains, if, and when, the market recovers.

In other words, allowing a short-term view to influence your long-term investment strategy could be a costly mistake.

Many of our clients have been through market corrections and difficult times in the past, and those who have stuck to their strategy over the last 6 or 7 years have found that their portfolio value is close to what we said it would be in the original projections included in their financial plan.

As I have said in the past. It is not my job to deliver exceptional returns. Markets and fund managers deliver returns, not advisers. My job is to stop clients making mistakes with their investment portfolio, to keep them focused on the reasons they invested in the first place, to help them in times of uncertainty and to put events such as this market correction into perspective.

WHERE TO FROM HERE?

I would be more than happy to meet with you so that we may discuss how current market fluctuations may be affecting your investments, or any other issue you would like to discuss. Together we can take this opportunity to review your risk profile, your financial plan and, if necessary, we will also review your investment options to ensure that they remain consistent with your financial needs and goals.

Please feel free to contact me if you would like to make an appointment.

I look forward to helping you with any investment needs, now and in the future.

Yours sincerely,

Colin McLoughlin