

## Fear & Greed

A constant theme in all of our discussions on investments is the importance of not letting emotions such as fear and greed lead our investment decisions. Right now greed isn't even getting a look in. Fear is taking over and a flight to safety is taking place at unprecedented levels.

Words such as "meltdown", "freefall", "plunge" and "plummet" dominate the headlines.

It's at times like these when strategy becomes more vital than ever. It is imperative that **logic** and not fear should prevail. It is at times like these that fortunes can be lost (selling at lows) and also be made (buying at lows). The banks that have created this crisis are now being dealt their just desserts.

The markets overall are holding up well. The price of oil has fallen dramatically, now hovering at \$95 not \$140, a fall of 32%, which will surely have an impact on inflation. Oil demand in the US is now at its lowest level for 26 years as individuals adapt their behaviour. According to M&G, even if oil went back up to \$150 a barrel (which they believe to be very unlikely), inflation would still come down to 3.5% in the UK during the next 12 months. Overall inflation, excluding oil and food prices, is actually relatively low.

## The Issues

The US government has just had to step in to ensure that AIG, one of the world's largest insurers, does not go out of business.

If AIG had gone under the knock on effects would have been huge. For example, they have insured some of the very risky investments entered into by many of the major banks. If those insurance policies were no longer there, many of those banks would have to set aside vast amounts of capital to cover potential losses on those investments. This would only add to the shortage of money (credit crunch) and could also lead other banks nearer to collapse.

The US government has also shown that it is willing to take whatever steps are necessary to ensure the security of the financial system. The UK government did the same (eventually) with Northern Rock. Their willingness to take action should provide reassurance.



## LEHMAN BROTHERS

Lehman Brothers is a different situation. It was an investment bank, not a high street bank with large deposits. The impact of them going out of business on other banks will not be as great. Lehman Brothers has therefore not been bailed out.

Unfortunately, sometimes companies collapse, whether they are banks or retailers. Companies (and their shareholders) are punished for poor management decisions. It is a necessary part of our financial system that companies should occasionally go under, weeding out the weak companies and leaving the strong ones to prosper.

Those holding Lehman Brothers shares will not be very happy right now, but unfortunately this is the risk of investing in equities. A properly diversified strategy reduces this risk and increases the potential rewards.

## HBOS

There has also been plenty of speculation that HBOS could be in serious trouble. According to HBOS, much of this is completely unfounded. However, a loss of confidence and a sense of panic could pretty much drive them under, even if the fundamentals appear okay.



The Financial Services Authority (FSA) is certainly satisfied that HBOS are fundamentally sound:

"Since the beginning of the current extreme difficulties in the financial markets, the FSA has worked intensively with all major UK banks to ensure they have credible capital and liquidity plans. We are satisfied that HBOS is a well-capitalised bank that continues to fund its business in a satisfactory way."

As I write, it looks possible that HBOS will merge with Lloyds TSB. This should provide the reassurance the market needs. **It is the rumours and uncertainty that cause the biggest issues.** Once the situation becomes clear then markets should stabilise.

## The Good News

Most economists believe lower interest rates are on the way. To quote M&G again, they believe UK rates will fall to perhaps 3% within a year, maybe even down to zero in the US.

Data we received today shows that the yield on the FTSE Allshare is now higher than that on 10 year Gilts\*. The last time this happened was in March 2003, which was the turning point of the equity markets after the lean period following the bursting of the dot-com bubble.

Perhaps current equity markets represent an amazing buying opportunity? Perhaps this is the beginning of the end of the credit crisis?

Perhaps this is a once in a hundred years opportunity to buy into markets? Perhaps fixed interest will deliver double digit returns over the next twelve months?

We have said previously that anything below 5,600 is a good buying opportunity, which means that current market levels present an even better opportunity. Remember it takes a 35% gain to replace a 25% loss, which is what recent market levels represent compared to their peak.

Do you want to take advantage of the "sales" to top up holdings? We believe it would be logical to do so, and if you would like to discuss this option please contact your usual adviser.

The decade from 1st January 2000 to 1st January 2010, is likely to be the worst decade in equity history. Perhaps even worse than the period from 1929 to 1938. However, the decade after this is likely to be a completely different story.

Be brave, be logical, stay the course, buy at lows and reap the long term rewards.

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\*Source: Thomson Financial, UBS estimates, supplied by Credit Suisse

All comments are solely the opinion of the author. Please do not act upon this briefing without first seeking professional advice.