

Newsflash: Swings, slides and roundabouts, but it's no playground...

10 August 2011

Watching yesterday's markets was a bizarre and worrying experience. The FTSE opened at 5,080, dropped, rose again, then plummeted to 4,791; a drop on the morning of almost 6%.

The "no news" theme continued. We scoured the news agencies to see if there was anything new causing these drops and there was nothing at all. No logic just fear. Then the recovery began and by lunchtime we were back where we started.

Then, amazingly, the FTSE started to post gains in the belief that the US Federal Reserve would make an announcement at 2.30pm US time. The FTSE actually closed 1.95% higher at 5,175. The intra-day swing had been a colossal 7.5%.

The concern then was that the Fed's announcement would disappoint and that markets would slide again. However when it came it was both effective and unusual. The Fed have made a "promise" to keep interest rates at their historic low levels for a further 2 years at LEAST. They also indicated that they would do whatever it takes to ensure the recovery is kept on track.

Not everyone voting at the Fed agreed, and it was the first time since 1992 that there were 3 dissenting votes. There are those who believe that making a commitment for such a long time is a dangerous strategy. Who knows what the future will hold?

A backwards glance

Our decision to buy equities was looking very worrying at 10am as the markets hit 4,791 and yet by the close of play it looked like the right strategy. After the Fed announcement I am confident that it is.

However the recent market turmoil has been a wakeup call. I believe that we are not entering a "bear market" but, if you will pardon the pun, we are certainly "not out of the woods" and the bears are still lingering.

Liquidity

There is a market saying: "The markets can remain volatile longer than many investors can remain solvent." In times of extreme market movements liquidity, or simply put the access to cash and funds that have not posted losses, is of critical importance.

Property and fixed interest

As mentioned in yesterday's briefing, just two weeks ago the return from these asset classes in our portfolios was looking very mundane, very boring and almost downright dull. We were looking at returns of just 3 to 4% over the year.

Yet yesterday they became our best performing asset classes over the year and we were reassured that we were holding them.

One of the reasons the returns looked dull was because we had been very defensive with our approach to each asset class. In relation to property we had picked funds that do not have any borrowings, had high cash levels for liquidity, and that avoid property shares. This meant we were underperforming the average property unit trust until recently, but during the recent market drop the sector average lost 6%, with some funds losing 20% or more. Our property portfolio over that period had fallen just 1.75% and remains up over a year.

I had a client yesterday who needed to release 20% of their portfolio to assist their daughter with a property purchase. It was reassuring to tell them that they could access these funds and incur barely any losses.

Cash is king

It is clear that we need to be more vigilant than ever in relation to risk in every asset class and as a result we are considering holding more cash in client portfolios.

We have already created more cash by reducing fixed interest, selling the Monument Bond fund for most clients. A typical cautious portfolio now has around 9% cash (excluding that which you hold personally), whereas a typical balanced or adventurous client has around 6% cash. We may create more by reducing property exposure.

If we believe this will be a temporary measure and we need to keep the cash to buy back into the stock market or another asset class, we will retain this cash within the portfolios. If we believe that this will be a long term position then we will return cash to clients as often you can achieve higher returns than we can.

However the UK is likely to follow the US and so we are looking at two more years of base rates at 0.5%. This is great for borrowers but awful for savers. We will only look at cash if we feel the risk/return characteristics of asset classes means that capital security is more important.

A fluid situation

We remain convinced that we can achieve the ongoing returns that clients need and our long and short term concern is inflation.

Beating inflation by our standard target of 5% is going to be tough but staying in cash is a guaranteed way to lose money in real terms. Not a single deposit account is beating inflation and that is not likely to change anytime soon.

I am also certain that volatility will remain a feature of markets. We will do our utmost to benefit from this volatility without ever 'betting the house'.

I hope in future briefings we can report on the reversal of the switches we have made recently, that we can do so at a 5% or more profit on each tranche. We will then have this money ready to go back in if markets drop again.

Thank you all for all your feedback, it is great to hear your views. Please do respond to yesterday's update (or today's) with your predicted FTSE level in 18 months time, and let us know whether you think the market drop will be short or long term.

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