

# What to do when fear trumps greed

By Tom Stevenson, 26 May 2010

## Markets have lost their appetite for risk. What strategies can see investors through the turmoil?

Markets do not move in one direction for long, so Wednesday's bounce should not be surprising – but nor should it kid anyone that the all-clear has been sounded. Investors face a volatile summer as fear and greed lock horns. The biggest challenge in the months to come will be making sensible judgements unclouded by emotion and avoiding both stubborn bullishness and irrational panic.



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There is no doubting which of these two emotions has held sway in recent days. The list of things to worry about has grown considerably longer of late. Top of the list, of course, is the sovereign debt crisis in the eurozone. The Organisation for Economic Co-Operation and Development (OECD) added to the noise on Wednesday, calling in its twice-yearly economic report for advanced nations to get more serious about cutting spending and raising taxes.

Elsewhere, concerns include the danger of conflict in Korea, turmoil in Thailand and the threat of a hard landing in China as the authorities move to dampen a nascent property bubble there. In America, financial regulation suggests a threat to recovery and growth. Closer to home, the new coalition government has made a promising start with a clear focus in the Queen's speech on the need to cut the deficit but an extended period of relative austerity beckons.

The market response on Monday to the proposed £6bn or so of fiscal tightening was reassuringly muted, with shares, gilts and the pound all holding up well. Investors abandoned their "keep calm and carry on" approach on Tuesday, of course, but it suggested that international financial markets are reasonably happy that there is a steady hand on the tiller.

Markets are likely to bounce around for some time as the focus shifts between the long list of potential and real negatives and the ongoing evidence that a sustainable recovery is underway in many parts of the world. As an example of this, Goldman Sachs recently said that its forecasts for GDP growth have risen around the world since its last round of predictions in December 2009.

The situation may feel very like late 2008, when the collapse of Lehman Brothers sent shockwaves around the global financial system. But the ongoing economic recovery means the background is very different indeed from the almost total financial and industrial shutdown back then.

There are other reasons to be sanguine. Corporate earnings are growing faster than expected on both sides of the Atlantic. Valuations, especially after the sharp correction are not particularly demanding. And it should be remembered that market setbacks like the one we have experienced over the past month are part and parcel of normal market conditions.

The correction is in line with historic norms. Research from the US shows that there have been 20 occasions since 1928 that markets have declined by at least 10% but not gone on to fall into a bear market (more than a 20% decline). The average time from the start of a bull market to this first correction has been 17 months while this time it has taken 14 months. Usually the correction has come after a gain of 57% but this time the S&P500 had rallied by 80% by its peak last month.

The strength of the rally since March 2009 probably argues both that a correction was overdue and that it may turn out to be a reasonably significant one. But the outlook is extremely uncertain and investors should not make assumptions either way.

Depending on your circumstances, you might consider a couple of strategies for coping with these difficult markets.

If you are still accumulating savings and investments, perhaps the best advice remains not to be blown off course by the market's volatility. The merit of sticking with a regular long-term savings discipline is that it forces you to gain exposure to the market when it feels most difficult – at times like this, in other words.

Adding to your savings when markets and investors are most nervous means you automatically take advantage of depressed asset prices. You will buy more of whatever you are looking to accumulate than would be the case if you only bought when it seemed like a good idea.

If you have already accumulated your savings and your primary concern is protecting your investments then the best advice needs to be more nuanced. It is disingenuous to say that running for safety is never a good idea. With the benefit of hindsight, it is clear that at times being out of the market is the best place to be. Anyone who claims to know how the euro-zone crisis is going to end is kidding themselves. The trouble is that investors do not have the benefit of hindsight – the times when it pays to be out of the market only become clear when it is too late. Unfortunately, we have to act in the messy here and now.

Anyone can say what they should have done. As one talented investor once said to me, “the difference is that I did it”.

Timing the market sounds like a great idea but it is almost impossible to do consistently well. And that means that the best protection for your savings is in diversification. Because we simply do not know what the future holds the most important thing to do is to keep our eggs in a range of baskets, both geographically and between asset classes such as equities, bonds and cash.

You might think, for example, that emerging markets offer the best growth prospects but it may well be that the more subdued growth in Europe or the US is on offer at such a better price that in the long run it ends up being a more profitable investment. The price you pay is just as important as the growth you achieve when it comes to your total return.

Another key element of that total return is the tax that you pay on your investment income and any gains that you achieve. Here too the watchword at the moment is uncertainty, with changes to capital gains tax a near certainty in the emergency budget next month.

Making sure that you have maximised your use of tax-advantaged vehicles like ISAs and pensions is more important than ever today.

When the headlines are most hysterical it is hard to maintain a disciplined approach to saving and investing but this is also when it is most important to do so.

*Note the value of an investment and the income from it can go down as well as up, so you may get less than you invested. The ideas and conclusions in this column are the author's own and do not necessarily reflect the views of Fidelity's portfolio managers. They are for general interest only and should not be taken as investment advice or as an invitation to purchase or sell any specific security. Past performance is not a guide to what may happen in the future. Investments in small and emerging markets can be more volatile than more established markets. For funds that invest in overseas markets, changes in currency exchange rates may affect the value of your investment.*