

The bulls are back in town

By Tom Stevenson, 5 August 2009

Investor sentiment has swung dramatically from pessimism to optimism since the March low.

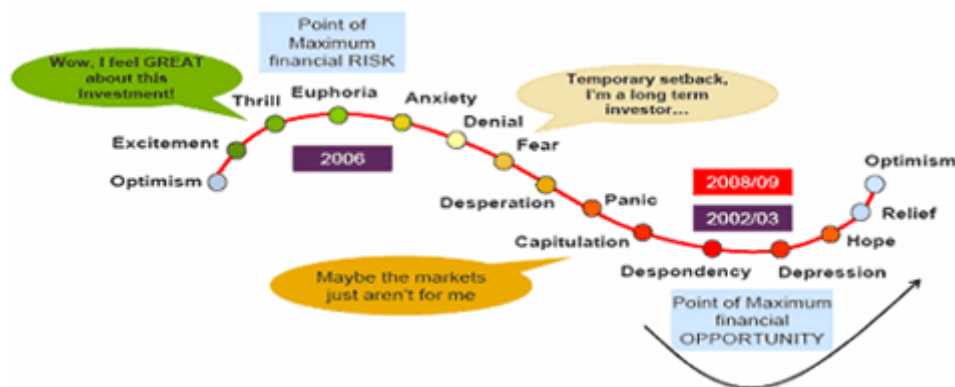
When I last wrote about investor sentiment, in March 2009, there was little doubt where we were on the emotional rollercoaster of the typical investment cycle. Markets around the world fell in the first two months of the year to multi-year lows as investors worried that the financial crisis would push global economies into their deepest slump since the Great Depression of the 1930s.

The savagery of the downturn was mirrored by a general depression about the prospects for all financial assets. Low share prices fed investors' pessimism about the economy which in turn pushed prices lower. Look at the image below and it is pretty clear where investor sentiment was in March.



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Tom Stevenson



Source: Westcore Funds / Denver Investment Advisors LLC, 1998, FIL

I recently trawled through the press cuttings from the beginning of March, just ahead of the low point for the MSCI World Index on 9 March 2009. What was remarkable was the consistency of the gloom. With very few notable exceptions (Fidelity's Anthony Bolton told an investment conference in Edinburgh that month that he believed markets were close to the bottom) commentators were unanimous in their pessimism.

As the chart shows, however, this kind of uniform anxiety is very often a signal that markets are at a turning point. The point at which investors believe that stocks can only head lower is very often the point at which they start to head higher. It is a persistent feature of bull and bear market cycles that the point of maximum despondency is also the point of maximum financial opportunity.

Sure enough, out of the wreckage of investor sentiment in March this year a new launch-pad for the market was constructed. Since then the MSCI World index has risen by 55%. If it is no more than a bear market rally, as

some have suggested, then it is one that few investors will have wanted to sit out.

Fast forward to today and the contrast could hardly be clearer. After a pause for breath in May and June, when investors questioned the sustainability of the rapid market rally in March and April, shares resumed their upward path in July. Markets in Europe, the UK and America are now all in positive territory for the year while Asian markets have continued to outperform as investors appetite for risk has increased.

For the first time in a very long while, investors must now start to ask themselves whether the new mood of enthusiasm is justified by events. Examples of the new bullishness include a recent poll of investors by Reuters, which showed that equity holdings are back up to levels last seen in the weeks running up to the collapse of Lehman Brothers. Reuters says cash holdings are at the lowest level since May 2007.

In a similar vein, fund analyst EPFR said that equity funds enjoyed net inflows of \$9.5bn in the week to July 27, the highest since June 2008.

Data from the UK shows that investors have regained their appetite for risk. The Investment Management Association's monthly data for June show the two best-selling fund sectors for retail investors were Asia Pacific excluding Japan and Global Emerging Markets. They took £300m together, compared with just £77m for the usual favourite, UK All Companies.

A clear indication of the improvement in sentiment was provided last week when the Chinese stock market, which has soared in value since the end of last year, fell by 5% on fears that Chinese banks might start restricting loans to cool enthusiasm for shares and property. When Shanghai has dropped like this in the past there has often been a knock-on impact in markets around the world. This time, however, investors largely shrugged off the news.

There are good reasons for improved sentiment. The first of these is the unexpected strength of corporate earnings in the second quarter of 2009. In the US around three quarters of the companies that have announced results so far have beaten expectations, with only 14% missing estimates. In Europe, the outperformance is less marked but more than half of companies are beating forecasts.

Another reason for investors to remain relaxed about the equity class as a whole is that shares are, by historical standards, not expensively valued. The price-earnings ratio of the MSCI World Index, which measures how expensive shares are compared to company profits, has risen sharply since March to levels last seen in 2007. However, even after this rise the ratio remains lower than at any point since the early 1990s.

Even the popular emerging markets are priced at an undemanding multiple of company profits when compared with most of the past 15 years or so.

Sentiment has clearly improved since the dark days of March, but there is little evidence that investors have become over-enthusiastic yet. Somewhere on our chart between relief and optimism seems about right.

Source: Datastream, years from 31.07.04 to 31.07.09

	July 04 / July 05	July 05 / July 06	July 06 / July 07	July 07 / July 08	July 08 / July 09
MSCI World US\$	15.7%	11.7%	18.0%	-12.7%	-23.6%

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