

Phew! What a six months that was...

By Tom Stevenson, 9 September 2009

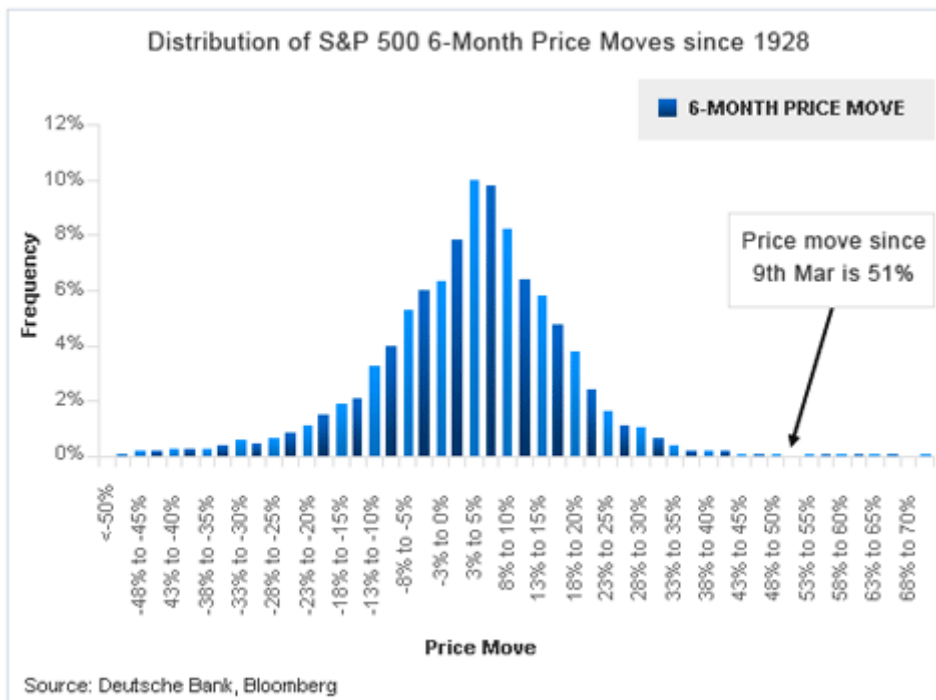
The performance of both equities and fixed income in the half year period since markets bottomed has been a once in a lifetime event.

Today is the six month anniversary of what we all hope was the low point for global equities in the 2007/09 bear market. Since March 9th, stock markets around the world have rallied sharply but some impressive number-crunching from the fixed income research team at Deutsche Bank makes clear just how rare an event the bounce in both equity and credit markets has been.



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The chart below shows the distribution of returns for the S&P 500 index across every six month period since 1928. The US benchmark has been used simply because American data over this kind of period is comprehensive and easily available – but the story is representative of many markets. What it shows is that around 10% of the time the market rose by between 2 and 2.5%, with increasingly less frequent occurrences of movements either less or more than this range.



What is interesting is what an outlier, the last six months have been. The 51% rise in the S&P 500 between

March 9th and September 8th 2009 is way out on the right hand side of the chart. In fact, movements of more than 50% have only been recorded in 0.5% of all the periods covered by the period since 1928. All of them were in 1932 and 1933 when the market was recovering from the Wall Street crash and the early stages of the Great Depression.

Not until the 6-month return falls below 45% do you get any entries from other years – this is where the great stock market rally of 1975 first shows up and the early stages of the great 1980s bull market and some other readings from this year.

Deutsche did a similar piece of number crunching for the credit markets to show the unusual nature also of this year's rapid contraction in the spread between the income yield on corporate bonds and that on risk free government bonds. The recovery in corporate bonds, or credit, has also only been bettered on very few occasions. In fact the reduction in spreads has been greater only 0.6% of the time since 1928.

So should investors worry that the extraordinary recovery in markets this year is set to unwind? Not necessarily is Deutsche's conclusion because tracking the subsequent six month performance shows that big rallies such as the one we have just enjoyed can often continue, albeit usually at a slower pace.

The one warning flag run up by this analysis is that the biggest rallies in the past have tended to start when the market was very cheap by historical standards. For example, at the starting point of the 1933 rallies the average price-to-earnings ratio was between 5 and 8 while at the end of the six month rally it had risen to between 12 and 14. This rally, by contrast, started with an average PE of 12 and it has now risen to 18 where shares do not look as obviously cheap as they were six months ago.

There's a similar story with the credit markets, where the recent rally has taken spreads back to close to their long-term average. Spreads are still wider than that long-term average but plainly there is less to go for than there was six months ago or at the end of 2008.

Isn't hindsight a wonderful thing!

Performance over 5 years					
	Aug 04 / Aug 05	Aug 05/ Aug 06	Aug 06/ Aug 07	Aug 07/ Aug 08	Aug 08/ Aug 09
S&P Composite US\$	10.5%	6.8%	13.1%	-13.0%	-20.4%
Source: Datastream, years from 31.08.04 to 31.08.09					

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