The Red House

Living with market uncertainty

"If I have learned anything from my 52 years in this marvellous field, it is that, for a given individual or institution, the emotions of investing have destroyed far more potential investment returns than the economics of investing have ever dreamed of destroying." John C. Bogle, Founder, Vanguard

Markets will be markets

Equity markets have the ability to thrill and terrify investors in equal measure on a more or less daily basis - they always have and they always will. The present turmoil in the Eurozone and the lacklustre pace of recovery in the UK economy, combined with the sensationalist, headline grabbing reports of '*meltdown*', '*contagion*', '*double-dip*' and '*deflation*' do little to steady the nerves. Markets go down as well as up. It is this very uncertainty that ultimately rewards those with the fortitude to own riskier assets, such as equities, over time.

It may be worth reminding ourselves how equity markets work. In essence, the market - being the aggregate of all participating investors - reflects, via the price of a company's shares, its best estimate of a company's value. Investors look into the future and try to gauge, and place a value on, the future earnings of the company. New information and the uncertainty surrounding what it means, such as whether there will be Greek exit from the Euro and a return to the Drachma, leads to volatility in the expectation of future earnings and thus in the price of shares, based on this new information. It's no surprise then that markets go up, down and sideways.

To place the latest market fall of around 10% to 15% in context, since 1955 the UK equity market has fallen by this amount or more on more than ten occasions. From its peak in 1972, the market fell by more than 65%. It is worth remembering too that at the height of the credit crisis in March 2009, the UK market (FTSE 100) stood as low as 3500, compared to around 5300 at the time of writing.

What can we do as investors in these trying times?

There are four key steps one can take to help find a way through the apparent dark clouds on the horizon. Perhaps the wise words of one of the America's most respected investment practitioners, Charles D. Ellis, are worth repeating and provide general guidance:

> *'Don't trust your emotions. When you feel euphoric you're probably in for a bruising. When you feel down, remember that it's darkest just before dawn and take no action. Activity in investing is almost always in surplus.'*

1. The first is not to panic.

The greatest wealth destroying emotional behaviour is to rush to the exit and sell out of equities and hold cash. Every decision to move out of the market is coupled to a decision to get back in again. Evidence shows that investors are very unskilled at making these timing decisions - private and institutional investors alike. Stick with your portfolio strategy. These may be trying times in the markets, but they are not unusual times.

2. The second is to have faith in your well-structured portfolio.

Your equity exposure is broadly diversified across several thousand companies in all major sectors and economies around the globe, both developed and emerging. Most TRH clients own a balancing position in high quality bonds that provide a safe haven against the uncertainty of the equity markets. Direct exposure to the debt of peripheral Eurozone economies is largely avoided or insignificant.

3. The third is to take a broader and longer-term view.

As an antidote to the gloom and doom in the media, consider the wider context. The global economy actually grew by around 4% in 2011, according to the IMF. The US and German economies have grown in the first quarter of his year, too. Emerging economies continue to grow strongly, even if at a lower pace than the express rates previously exhibited in countries such as China and India - estimated, in aggregate at around 6% for 2012, by the IMF.

It is interesting to note too, that for the first time in many years the UK's exports to non-EU countries have exceeded those to the EU. In the past three months there has been a 105,000 rise in employment in the UK. Ernst & Young estimate that UK companies hold more than £750 billion cash on their balance sheets waiting to be invested in plant, machinery and jobs, but it remains uninvested due to the ongoing economic uncertainty. This figure represents around 50% of UK GDP. It won't take too much investment for the picture to change. US companies hold more than $2 trillion of cash, a little under 15% of their net worth, the highest level since 1955, according to The Economist. The future and broader picture looks less bleak than the headlines may suggest. This corporate cash hoarding is part of the problem today, but part of the solution tomorrow.

4. The fourth and final action is inaction.

Sit tight and don't keep looking at the value of your portfolio on a daily basis, you'll only drive yourself mad with the daily volatility you will see. *'I'm richer, I'm poorer...'*. As one old investment saying goes, *'look at your cash everyday if you like, your bonds very two years and your equities every ten years'*. John Bogle, one of the wisest and most respected investors in the world, once said:

> *'No matter what happens, stick to your program. I've said "Stay the course" a thousand times, and meant it every time. It is the most important single piece of investment wisdom I can give you.'*

We concur. If you would like to talk to us about any issues or have any questions on concerning your portfolio strategy, please do not hesitate to call us. After all, that is what we are here for.

Gareth Marr

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Notes and risk warnings

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The registered office address of the Firm is 146 New London Road, Chelmsford, Essex CM2 0AW