

Investment Brief

Stockmarket volatility Selftrade head of research Stephen Barber says market downturns can present good opportunities to make well considered investments but don't be distracted by what the majority are doing

Be seen but not herd

JK Galbraith said "In economics, the majority is always wrong," and the present state of the markets could prove to be an opportunity to test the worth of the economist's claim.

A recent survey shows that most people believe the world's biggest stockmarkets will fall for the next six months.

The credit crunch started a period of volatility in global stockmarkets that does not yet seem to be drawing to a close. Fear of US recession is a major driver behind the capricious markets of recent months.

A more optimistic note has been struck by rate cuts from the Federal Reserve and Bank of England, president George Bush's fiscal stimulus, some reasonable company results, particularly from FTSE big caps, and a continued growth story from China and other emerging markets.

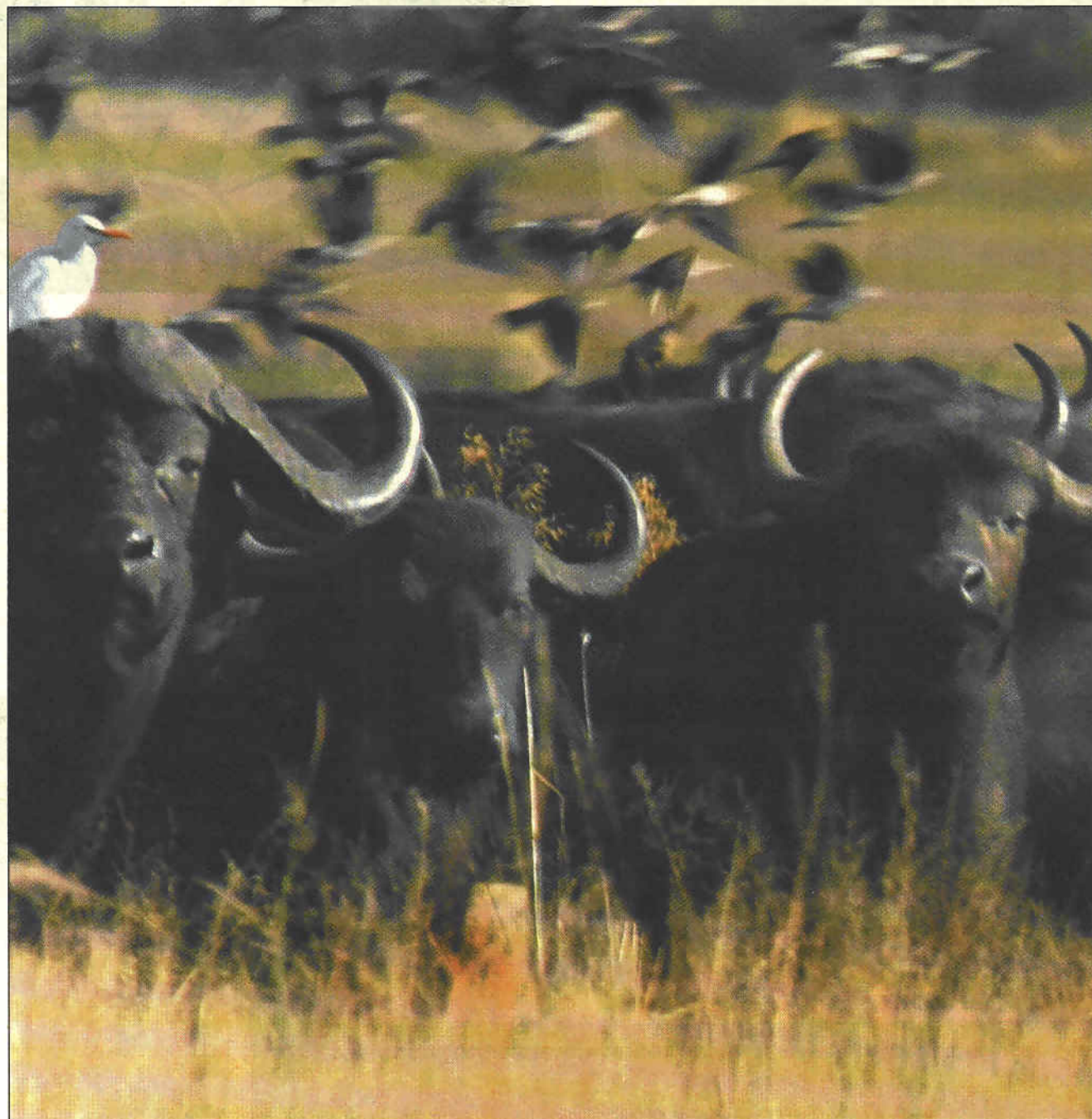
A balancing act is being performed by Bank of England governor Mervyn King and the monetary policy committee to stave off recession by providing sufficient economic stimulus through lower rates while guarding from the dangers that inflation may bring.

We will probably not know if it has worked until the worst is over. This is what analysts mean by uncertainty and it is the sort of thing that makes stockmarkets nervous.

It is human nature that we tend to prefer investing in bull rather than in bear markets. However, for those investing for the longer term, periodic market weakness presents opportunities. Where the herd mentality is resisted and there are clearly considered investment objectives and attitudes to risk and carefully selected investments, any market can prove profitable.

Apart from anything else, when else in the cycle do investors expect to be presented with value than during market downturns?

This is reflected in earnings' multiples on both sides of the Atlantic. One



must treat current earnings' numbers with care but the S&P 500, for example, with price/earnings ratios of around 18, is not cheap but is as low as it has been since the mid-1990s and way off the heady days of the tech boom when figures of 30 or more were the norm. The FTSE 100 is at a similar level and appears to have discounted in the downturn, so long as central banks keep cutting rates.

Such numbers are represented in the underlying investments of some of the bellwether unit trusts and Oeics whose composition includes the leading stocks from these and other major indices. This competitive sector remains one to exploit. Investment trusts are also worth examining since not only do these instruments offer exposure to potential market value but

they also tend to trade at a discount to net asset value.

Figures from the Association of Investment Companies show that average discounts have increased steadily since last summer as the market has become more volatile. They peaked at 11 per cent in December before falling back in January. This means there is potential value both in the instruments and the underlying holdings.

As markets become more volatile, it is usual to see discounts widen although this varies between instruments and sectors. It is also affected by the development of discount control mechanisms.

There is the risk that the discount could widen further or not contract as rapidly as investors hope. As with all these securities, their values can fall as well as

rise. Nevertheless, a bit of research may unearth some investment gems.

The attention of many investor has been focused on on Isas. The flexibility afforded by a self-invested Isa means that investors not only have a choice of what to invest in but they can also decide on market timing. It is a point missed by many Isa holders that cash subscribed can be invested with a degree of leisure, either in lump sums or in regular tranches. Dripfeeding funds into the market can be a sensible tactic for people wanting to manage risk in volatile markets. It allows one to spread the risk over a longer period, buying in troughs as well as peaks and thereby smoothing returns.

There are three investor reactions common to market turbulence – continuing as if conditions had not changed,

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moving into cash until the market recovers or simply doing what the majority of others are doing. The more thoughtful investor will recognise the opportunities as well as the threats of the altered environment and will adjust their strategy accordingly.

As most people will realise, waiting until the market is relatively expensive means missed opportunities. This may have implications for risk as the future is uncertain. There remains a chance that we face at least a recession in growth. In itself, this does not much matter so long as the landing is soft and the recovery swift. It may not be clear that there has been one until it is over.

Perhaps Galbraith was on to something after all. Only it is not that the majority is always wrong, it is that it has no idea as to the timings.