

## INVESTMENT UPDATE

Recent events have placed the UK economy in a precarious position and clearly the financial world is changing rapidly. While there are difficult times ahead it is important to focus on long term objectives and look to history for guidance. We are currently experiencing a 'bear' market that usually precedes an economic slowdown or recession. Recent bear markets have lasted on average around a year with shares falling 35 per cent from recent highs. The reasons for these events are often different in nature and, on the current situation, have been likened to everything from the 1970's oil crisis to the Great Depression.

It now seems inevitable that the UK and other developed economies will enter recession. The pertinent question now is how deep and for how long? It is, of course, a question that no one can answer as much depends on how the economy reacts to the efforts of central government so far and what, if any, further steps are needed to bring stability to the banking and financial sectors.

What comes next has to be a restoration of inter-bank lending and a gradual return to normality in corporate and mortgage lending. Attention must also be given to reducing interest rates further that are passed on to consumers. Any inflation in the system should have peaked and with commodity prices falling rapidly further reductions in interest rates are essential to lessen the impact of a major slowdown. The adverse consequence of recession is a rise in unemployment and the figures could exceed 3 million in the UK within two years.

Out of adversity comes opportunity and some positive factors are presently being overlooked. With the rating on equity markets historically low and with inflation and interest rates set to fall sharply the yield on UK equities and bonds is almost the same. Historically, this has been followed by equity out-performance.

Another interesting perspective is regarding UK corporate bonds where the credit spreads are historically high to reflect the increased risk relative to government gilts. This is because of the credit crunch and the main reason why corporate bond values have fallen reflecting higher yields. Again, following previous periods corporate bonds have outperformed as spreads have narrowed.

Our policy is to manage risk over the long term and it has been alarming how well -diversified investments have offered little protection during the current crisis. It is also difficult to predict such events and take evasive action. All asset classes have been adversely affected even cash that has not been the safe haven it was. However, it is time in the market rather than timing the market that is paramount to investment success.

In previous market slumps we have always remained invested and this has more often than not proved the best policy as we have fully participated in any recovery. Any such recovery tends to be a series of recoveries over time that can be unpredictable in nature and timing.

Where we do most of our work is in re-balancing portfolios to maintain the overall risk profile and identifying fund switches into areas we consider better suited to future market conditions. We know interest rates will fall sharply and fixed interest funds will perform well so we are moving more into this area. Equities will recover in time with emphasis on large stocks ahead of the mid-cap and smaller companies. Again, we are looking to highlight these areas.

If history is anything to go by we are towards the end of this particular bear market with plenty of sectors already pricing in the worst.

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