

Let's talk wealth management



As founder of Wealthflow LLP, Duncan Glassey's advice features regularly in finance journals and national press. If you would like to talk more about specialist wealth management and financial life planning you can call Duncan direct on : **0845 468 0037**

Duncan R Glassey CFP[®] MSI AIFP FRSA



The Scotsman newspaper : SIX PART INVESTMENT SERIES - Part 2 : published Saturday 25th July 2009

e : duncan.glassey@wealthflow.com www.wealthflow.com

The risks are greater when investing during a recession – but then so are the rewards.



DURING both recessions and expansions, share values are the price tag we place on all the expected future cash flows. Why do share prices change? If I asked a group of investors why share prices have gone down over the past 12-18 months, I would probably hear a long list of possible reasons.

We can take all plausible sounding reasons and say they are going to be reflected, in one way or another, in just two broad factors – investor expectations about future cashflows and the price we are willing to pay for future cashflows.

So we can boil down all these changes we see in share prices, no matter how violent, to some change in expectation about cashflows or the price we are willing to pay.

What else do we know? We know that risks increase during a recession, and these are very real risks; businesses fail, jobs are lost, incomes stagnate or are reduced.

Some investors cannot bear these risks, but since they are unavoidable for the economy as a whole, if someone wants to reduce their risk they have to find someone else who is willing to take more risk. There is no way we can entirely reduce risk for everybody.

So if stock markets compensate investors for bearing risks and risk is higher during recessions, then expected returns from risky assets should be higher during recessions.

Searching through news archives, let's compare time periods. Take 9 December, 1974, which, by coincidence, was the very first day (measured by Dow Jones Industrial Average Index) of what turned out to be one of the longest and strongest bull markets in American history.

That day the Dow Jones Average rose a piddling 0.2 per cent or so, but in subsequent days the market began to roar upwards. If we had waited until 1 December, 1975 for proof that news was improving we would have found that the Dow Jones Industrial Average had risen by almost 48 per cent over that period.

This is a good example of how, when the news is at its most grim, expected returns are likely to be higher than average.