

Let's talk wealth management



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What should investors do now?

Let's turn to a question we've heard frequently in recent weeks and months, granted we're in a recession now but shouldn't we have seen it coming ahead of time?

Here's the challenge of trying to see it ahead of time. According to the National Bureau of Economic Research the recession started in December 2007, but was it clear to everyone at the time that we were in a recession?

If we look back to newspaper articles in June 2008 we would find contradictory analysis, some see no recession, others confidently predict recessionary times, so which one do you listen to as an investor? Truthfully, you don't know.

You might look for bits of evidence that would suggest or confirm that we are in recession, or not in recession. In July 2008 well known companies filed for bankruptcy, but a few days later we read that Apple has sold one million iPhones in just the first three days of their new product launch. It would seem plausible that a brand new iPhone is the very definition of an unnecessary luxury purchase that could easily be deferred by anxious consumers if they're worried about recession.

This news item was seen to be very inconsistent with the idea that we're in recession. So once again which one do you count most heavily – we don't know.

The most recent recession before our current downturn began in July 1990 and ended in March 1991. Let's use this as an example of how difficult it might be to use information about the beginning and end of a recession to change the overall asset allocation of a portfolio.

So the recession starts in July 1990 and it coincides almost precisely to the moment when the stockmarket falls over a cliff.

It looks like we're onto something; all we had to do was get out of shares when the recession starts.

Well if we followed that logic it would seem the most plausible route to success would be to sell shares at the start of the recession and buy shares back when the recession is over. So when is the recession over? It's over in March of 1991, unfortunately by that time share prices have recovered and are actually 5% higher than they were when the recession started. That doesn't seem to be a very good way to enhance overall returns; we're actually buying back higher rather than lower. If we look at historical performance data it looks as if what we ought to be doing is try to identify when we are roughly half way through the recession and then buy shares, and maybe we will get it right at the bottom. The problem is we didn't know the recession had started until after it was already



over - long after the market had made a bottom, long after the recession was over, and by that time we're well on our way to an entirely new bull market cycle. This would appear to illustrate the challenge of using economic data to restructure our investment portfolio; there is just too much noise and uncertainty to develop a reliable timing rule around economic data.

But there is a bigger issue here as well. What if we had seen it coming? Suppose we all agreed, two years ago, that we were entering a very scary and dangerous period for the economy. To some people the solution is obvious, there's a train coming down the track, you're on the track, everybody jump off and get out of the way. This is the wrong analogy; it goes back to this idea of the whole economic risk being held by all of society. There's no way we can all jump off the train tracks at once.

The pain of a recession unfolds gradually over time, but investors bear the full expected impact as soon as the danger is recognised.