

## 30 September 2008 – Wealth Management Bulletin

The last few weeks have seen events that the vast majority of professional and amateur investors would have considered unthinkable one year ago. On 29 September the rescue package supported by both the Treasury and the Federal Reserve was blocked by Congress.

**These are historic days and many investors will be nervous.**

The situation is changing so rapidly that by the time you read this note there may well have been further radical developments. The tricky subject is to work out how to react to the huge river of news that flows 24 hours a day.

The equity portion of all of our investors' portfolios has lost money in the last 12 months. The losses on this portion have on occasion been vicious. The strong emotional urge is to take action. Ideas include repositioning portfolios to somehow cope better with the anticipated recession, moving all money to gilts or gold, purchase put options on the FTSE and so on.

While all these ideas are supported by apparently authoritative commentary history suggests that this sort of reaction to difficult, or dreadfully difficult, times is a good way to consolidate losses and miss the next upturn. Time and time again as I delve into the statistics on retail investors behaviour, or into the reactions of those running "balanced managed" or "cautious managed" funds I see intelligent people selling assets at (with hindsight) exactly the wrong time. It is this behaviour that can destroy wealth.

The risk is that in the heat of the moment, in the eye of the storm, actions are taken that in hindsight were irrational panicking.

All of our clients have diversified portfolios. Some are more heavily invested in equities than others, but all are diversified. They are diversified geographically with holdings in all major markets. They are also diversified by asset type. Most clients have substantial holdings in gilts. This diversification does not remove the pain, but does often dampen volatility considerably. At the moment for instance index linked gilts have posted unusually high returns. Indeed if you are approaching a regular review it is likely that we will be recommending that you rebalance by taking some profit on index linked gilts and purchasing more equities.

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All our clients have also discussed their cashflow requirements with us. There is no client who should be selling investments month to month to fund cashflow requirements. The vast bulk of clients have a substantial cash buffer that is in place to deal with periods just such as this one.

We expect that the cash buffer will be replenished in the future. We do not know how far in to the future nor do we know how much more pain will be inflicted before a recovery takes hold. But we do know that recoveries have always occurred.

Most of our clients will remember the 70s well. Imagine how bad things looked in mid 1974. I have written about this in a previous bulletin. At the end of 2002 the market was approximately 36% down over three years (and that includes dividends received). There have been other times when it may have appeared that capitalism was broken. Investors in the US in 1968 did not see a positive return until 1976. Property investors in the mid to late 1980s had to wait at least four years to see a positive return (depending on which dataset we use).

We know that the successful UK retail investor is in the minority of UK retail investors. One of the things that differentiates the successful investor is that he or she does not buy and sell regularly. He or she makes calm rational decisions based on long term scientific data coupled with his or her cashflow requirements and long term life and lifestyle goals. The regular chopping and changing will quickly allow fees and taxes to reduce returns.

So is there anything at all that clients should be doing? Yes. As I have commented before if you have over £35,000 on deposit, and virtually all of our clients have far higher deposits than this, then review whether your deposit arrangements are prudent. We have no view on whether one bank is safer than another one. The cleverest minds in the world have not yet managed to work out which the better banks are since their balance sheets are completely impenetrable. Indeed this is essentially the cause of the current financial crisis. I am more concerned about bank security than I was 6 months ago. Things to consider include splitting between several providers, perhaps using gilts, using Northern Rock, using money funds, using offshore money funds, increasing regulatory protection above £35,000 through using life assurance structures and so on. If any of these items are of interest do contact David Nye or me.

I have included with this bulletin an article from Weston Wellington published on 30 July titled "Is It Different This Time". Sir John Templeton died earlier this year. He was one of the great pioneers of stock market investment and his 16 rules are required reading for anyone in the investment world. One of his most famous quotes is:

*"The simple phrase "It's different this time" are the four most expensive words in the English language"*

Thanks to Weston Wellington for the article, which is really a series of quotations. I hope that they help to put the current events in some sort of context.

If you would like to discuss any aspect of your finances please do not hesitate to contact David Nye or me.

**Ben Sherwood**  
**Principal**

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## Is It Different This Time?

As stock prices have slumped around the world over the past year, investors have been confronted with a barrage of grim news - falling home prices, rising costs for food and fuel, and worries over the fragile health of the banking system. Some have concluded that the current state of affairs bears little resemblance to the past and are questioning the wisdom of maintaining consistent exposure to equities at all.

We don't know what the future for this business cycle looks like, but we do know that on many occasions in the past, investors were confronted with "unprecedented" events that tested their willingness to maintain a diversified approach. A few examples:

- "On Wall Street, the most unnerving stock market reports since the Depression 1930s became daily more dismal."  
*Time*, "The Economy: Crisis of Confidence," June 1, 1970.
- "Fed up with rising food prices, thousands of women took to the streets in protest. . . . [President Nixon] announced that ceilings were being imposed on prices of beef, pork and lamb."  
*Time*, "Changing Farm Policy to Cut Food Prices," April 9, 1973.
- "The only way that the US can scrape through the next several years without major economic and social disruptions is to ease off dramatically on energy consumption."  
*Time*, "The Arabs' New Oil Squeeze: Dimouts, Slowdowns, Chills," November 19, 1973.
- "There have been multiplying signs that the long American romance with the big car may finally be ending. . . . Economists generally are agreed that the era of readily abundant fuel has ended for good."  
*Time*, "The Painful Change to Thinking Small," December 31, 1973.
- "Investors have been frightened of an economy that seems out of control. . . . The stock market has scarcely been so shaky since 1929. . . . A Gallup poll published last month found that 46% of adults feared a depression similar to the classic one of the 1930s."  
*Time*, "Seeking Relief from a Massive Migraine," September 9, 1974.
- "The woes of inflation and stagnation have touched nearly every American, but while some people are only slightly bruised, others feel as if they have gone ten rounds with George Foreman and are down for the count. . . . Pawnbrokers are gaining from once affluent people who have lost their jobs and are trying to get anything that they can out of jewelry or expensive cameras or appliances."  
*Time*, "Who Is Hurting and Who Is Not," October 14, 1974.

- "Financial markets at home and abroad have been devastated in recent weeks as frantic traders and investors scrambled to come to grips with the anti-inflation policies of the Carter Administration and the Federal Reserve Board. . . . After a nervous September, Wall Street succumbed to despair, and the stock market was bloodied by what is being called the October massacre."

John M. Lee, "Tumult in the Markets," *New York Times*, November 6, 1978.

- "Fortunes were conjured out of thin air by fresh-faced traders who created nothing more than paper."

Walter Isaacson, "After the Fall," *Time*, November 2, 1987.

- "The next recession won't look like any that has preceded it in recent decades. . . . We are so heavily indebted that a slump would quickly turn into a Latin American-style depression."

Ashby Bladen, "Borrowing to the Bitter End," *Forbes*, September 4, 1989.

- "Chase Manhattan, the second largest US bank, is letting go 5,000 employees, or 12% of its work force, in a struggle to remain solvent. . . . The construction industry has creaked to a virtual halt after a decade of overbuilding. . . . From stock markets to supermarkets, high anxiety rules the day. . . . Now the specter of war, rapacious oil prices, and a far-reaching recession haunts political and business leaders everywhere. . . . The banks are basically pushing panic buttons everywhere."

- "I want to say we're in a recession, but that's not a strong enough word. In some regions, it's a depression."

John Greenwald, "All Shook Up," *Time*, October 15, 1990. Final quotation attributed to William Hensler, chief executive, Wickes Lumber.

- "Imagine every office building in Manhattan empty, a commercial ghost town. Now double it. That's how much vacant office space—500 million square feet—there is in the United States today. Behind much of that empty office space stands the nation's banking system. . . . The worry today is that the real estate recession, which is spreading nationally, could severely weaken the banking system, pulling down many smaller banks and a few big ones as well. . . . 'Our real estate market is as bad as we've had since the 1930s,' said Leo Spang, a Boston banker and president of the Real Estate Finance Association, a trade group."

Steve Lohr, "Banking's Real Estate Miseries," *New York Times*, January 13, 1991.

- "Falling real estate prices and the fragile state of the banking system make this recession unlike any other and extremely difficult to forecast."

John R. Dorfman, "First Boston's Bear, Carmine Grigoli, Refuses to Stop Growling Despite Stocks' Big Rally," *Wall Street Journal*, February 7, 1991. Quotation attributed to Carmine Grigoli, chief investment strategist, First Boston Corp.

- "The nation's top auditor said today that many more banks were effectively bankrupt than regulators had recognized. . . . 'The bank insurance fund is nearly insolvent, and I cannot overemphasize how important it is to restore it as quickly as possible,' Mr. Bowsler [Comptroller General] told the Senate Banking Committee."  
Stephen Labaton, "Bank Deposit Fund Nearly Insolvent, US Auditor Says," *New York Times*, April 27, 1991.
- "We're going into one of those long periods where the market does nothing except consolidate this huge move up we've had. Dow 4000 is going to be with us for a long time."  
Daniel Kadlec, "Will Weary Legs End 20-Year Bull Ride?" *USA Today*, December 6, 1994. Quotation attributed to Seth Glickenhau, senior partner, Glickenhau & Co.
- "This economic convulsion is unprecedented in the post-World War II era."  
Robert J. Samuelson, "A World Meltdown?" *Newsweek* September 7, 1998
- "This time it is different. This time the market won't be so quick to bounce back. . . . Who can look at the world right now and not conclude that things have changed dramatically?"  
Joseph Nocera, "Requiem for the Bull," *Fortune*, September 28, 1998.
- "Wall Street stocks have plunged—Merrill Lynch down 59%, Morgan Stanley down 59%, and Lehman Brothers down 67%. . . . The real problem is with the risks that are unquantifiable."  
Bethany McLean, "Can the Brokerage Stocks Come Back?" *Fortune*, October 26, 1998.
- "Investor nervousness pushed stock prices lower yesterday and sent signals of distress through the corporate bond market. . . . Many companies are overloaded with debt at a time of slowing economic growth. Among the stocks leading the decline yesterday were those of companies sensitive to the business cycle. . . . A Morgan Stanley index of 30 of these stocks plunged 4.7 percent yesterday, reflecting the worry that the economy may be headed for another recession."  
Jonathan Fuerbringer, "Negative News from Some Blue Chips Takes Heavy Toll," *New York Times*, October 10, 2002. [Note: major US stock market indexes registered multi-year lows on October 9, 2002.]

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