
Can we predict the future?

Wealth Management clients have, by and large, enjoyed good returns on their portfolios over the last 9 - 12 months. The last three months have been weaker but the overall trend has been positive for a considerable period of time. In fact, barring the occasional blip, stock markets have been on an upward surge now for nearly four years. Understandably some of our clients, both new and old, are slightly nervous about the future, especially with the tech bubble down turn of 2000 to 2002 still very fresh in investors' minds.

Several prominent and apparently authoritative commentators are suggesting that equities are "overvalued" (whatever that means) and that a serious adjustment/correction/crash is on the way. Given these comments some clients might wonder why we continue to recommend equities or how we should react to such commentators' views.

A couple of weeks ago the Times ran an article a day Monday to Friday explaining why stocks were overvalued followed by an article on Saturday explaining why equities were not overvalued.

At least two clients have mentioned the recent Morgan Stanley pronouncements. Surely Morgan Stanley know something about equities?

Let's look more closely at the comments that were made: -

"Morgan Stanley announce a treble sell indicator or a "Full House" signal". This signal has only been indicated 5 times since 1980. Tuen Draaisma is Morgan Stanley's Chief European Equities Strategist and he advised that the Morgan Stanley model predicted a 14% correction over the next 6 months though he warned that "it could be more serious". These comments were published in the Telegraph and the Times.

This is powerful stuff – Morgan Stanley manage \$700 billion and are widely respected. However, and as usual, a proper reading of the articles in question paints a less straightforward picture. What the paper from Morgan Stanley actually says is that in the past these indicators have been followed by an average 15% drop in the next six months. One indication Hillier Hopkins are always keen on is to look at what actions were actually taken following this prediction. An average retail investor might think that a "Full House sell signal" and "14% drop in next 6 months" might just indicate that this might be a good time to get out of European equities. So have Morgan Stanley sold their equities? Not a bit of it. They have trimmed back their overweight exposure. For those that have been with Hillier Hopkins for some time, that sounds suspiciously like our regular rebalancing exercises, though to be fair to Morgan Stanley they also try their hand at tactical asset allocation.

What else have Morgan Stanley got to say? The full house sell paper was published on 4 June and its full title was "A Full House Sell Signal – We Stay Neutral Equities".

- On 19 June Morgan Stanley said:
"The global economy should remain strong and benign, supporting risky assets"
(Stephen L. Jen, USD To Reassert)
- On 19 June Morgan Stanley said:
"We remain [*in*] overweight equities at 4% over [*the*] benchmark"
(Jonathan Garner GEM Equity Strategy)

and so on.

My purpose in looking at these Morgan Stanley commentaries is not for a moment to suggest that Morgan Stanley know little about investment management. Morgan Stanley is a huge global investment bank and is widely respected. The key points I wish to make are:-

1. Even the wonderful UK press is superb at selective out of context quotes that put a completely different meaning to a phrase compared to that which the author intended.
2. Hillier Hopkins, Morgan Stanley, and Warren Buffet do not know *which* assets are going to perform poorly in the next three years. We do know that *some* assets will perform poorly over the next three years – we just do not know which ones or when. We also believe that over the very long term equities will offer returns that are better than inflation or deposit rates.
3. Many large organisations will have many published views that appear contradictory. An acid test is to look at how that organisation is managing its own portfolio. If great or ghastly equity returns are predicted, how does that affect the investment policy of the organisation? In many cases the adjustments to portfolios are tiny by comparison with the language in the accompanying commentary.
4. Many commentators and UK papers run predictions on equities, gold prices, housing prices and skirt lengths. If you retain your weekend papers for a year you will find that every combination of outcomes has at some point been predicted. When at some point in the future equities have fallen, gold has soared, house prices have gone nowhere and skirt lengths have shortened the Times will be able to reference an article saying exactly that.

Our investment advice is founded on Nobel prize winning research – we use a scientific basis for our recommendations. We continually examine new research and new ideas and on occasion tweak our advice as a result of this research where we believe we can produce a material client benefit.

The last few years have been exceptional, there will be years in the future when our portfolios perform less well and lose money. This volatility is an unavoidable price of superior returns. Trying to time the market is a high risk strategy. Some market timers will win and some will lose, though due to increased trading costs and the jerky nature of stock market movements the average return of the market timer will be less than the average return of the market. We do not know how to identify which market timers will succeed in the future. We recommend long term investment – this keeps costs low and allows investors to receive the equity premium they deserve for investing equities.

As usual any queries or comments drop me a line.

Ben Sherwood

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For more information on any of the issues raised your current Hillier Hopkins contact will be happy to assist you. Alternatively, please call us on 01442 220788 to speak to one of our advisers. Hillier Hopkins LLP are registered to carry on audit work by the Institute of Chartered Accountants in England & Wales and authorised and regulated by the Financial Services Authority.

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