

Riding the bear market

With recession imminent, Peter Dunn asks whether it's better to hold off saving for the long-term until the good times return

Stock market turmoil; bankrupt financial institutions; property prices collapsing; imminent recession – it's not exactly good news week as the financial soap opera continues to unfold.

You may be asking if there is really any point saving for the long-term in the present climate. Would it be better to hold back and wait until the news is more positive and the good times return once again?

Let's wind the clock back to 2002 when stock markets were well into their third year of a downturn, or bear market. We would periodically pick up the phone to clients who were worried about

their pension funds and wondered if they should consider baling out of equities. The FTSE 100 index had dropped by around 50 per cent and was showing little sign of recovery.

Our advice to our clients at that time was 'keep the faith' and not to sell in a depressed market. In fact, we were actually suggesting a contra-cyclical approach: that they should be actively investing into equities; not enormous lump sums but lesser amounts and on a regular basis.

Keeping the faith

Fast forward six years and markets once again appear to be in crisis. The FTSE 100 index has dropped 25 per cent over the last year and the global impact of the 'credit crunch' is potentially much more damaging than the dot.com boom-bust cycle of the late 1990s. Yet the difference we are noting this time is the reaction of our clients, or rather the lack of it. We are receiving far fewer distress calls; in fact most clients that we talk to seem quite happy to keep investing in equities.

I've a couple of theories for this. The first is that back in 2002, property was still booming and offered an attractive alternative asset class to invest into. In 2008, the property market is depressed and the short-term outlook remains poor. Very few dentists are investing in residential property, especially buy-to-let properties.

The second theory is that the events at the beginning of this decade are still relatively fresh in our minds and those clients who heeded our advice and remained actively investing in equities actually did rather well, as the UK FTSE 100 index doubled in value over the ensuing three years.

According to Jim Wood-Smith, the head of research at the investment managers Williams de Broë, the recent events surrounding Lehman Brothers and HBOS have taken us significantly closer to the end of the credit crisis and as the sub-prime issues are resolved, one at a time, the closer to the bottom we get.

Regardless of whether markets are already trawling along the bottom or have further to fall, the rationale behind our advice to clients back in 2002 remains just as relevant today. If you believe that markets are cyclical and will eventually bounce back, it is not a good time to heavily sell equities when they have already taken a substantial knock, especially if the fundamentals look good. Currently price/earnings ratios, which measure how expensive stocks are, are at a much lower level than when the FTSE 100 bottomed out in March 2003 which indicates there is good value to be had out there in the stock markets.

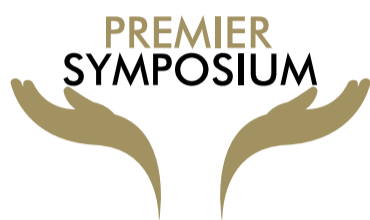
Active management, reduced risk

Of course, we are not suggesting that 100 per cent of a portfolio should be exposed to equities in the current climate, even for a client with a higher tolerance to investment risk, as there may still be further fall-out. A good strategy for many investors is to maintain exposure to equities but diversify into investments that can still benefit even when markets go down.

A well-structured portfolio for a medium-risk investor is likely to be diversified between the following asset classes:

Fixed interest

At the base of a well-structured portfolio would be a selection of fixed-interest securities



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such as government securities (both conventional and index-linked) and corporate bonds.

UK equities

A weighting in equity-based securities, commencing with UK equity funds, would be included to achieve long-term capital growth and income.

International equities

Overseas investments are important for a growth portfolio as they give access to parts of the global economy that are unavailable in the UK. For example, exposure to areas such as Asia can provide attractive growth opportunities.

Commercial property

Commercial property is a key element in a balanced investment portfolio as it is not directly influenced by market conditions in the same way as stock market investments. Even when share prices are in the doldrums, property can still deliver healthy capital growth and a decent income yield, and can potentially deliver more stable returns than shares.

Hedge funds/structured products

These are an asset class that do not correlate directly with fixed interest and equity markets and, perhaps surprisingly, given their current reputation, can be a very useful tool in lowering the overall risk and volatility of the portfolio.

Exchange Traded Funds (ETFs)

These provide exposure to a particular index such as the FTSE 100 or S&P 500 and track the performance of this index. They are also low cost and provide passive exposure to the index.

As ETFs are actually listed on an exchange they trade in 'real time' so can be bought and sold at any time during market hours, rather than only being traded once a day like unit trusts.

Commodities

Then at the top level there may also be exposure to commodities as they provide long-term diversification and a hedge against global inflation.

Cash

Lastly, some cash should be maintained in the portfolio to provide some liquidity and immediate access to other assets when the fund manager feels the timing is right.

Managing your investments

How do you readily access this style of portfolio for your pensions and other investments? It is possible that your financial planner actively manages the investments on your behalf, using research made available by independent institutions. However, a fully diversified portfolio as described above may compose of some in-

	% In Asset Class
Fixed Interest	20%
UK Equities	21%
Overseas Equities	25%
Alternative Assets	30%
Cash	5%
TOTAL	100%

Example of a typical medium-risk diversified portfolio

vestments that are only available to institutional investors.

Increasingly, financial planners see their role more as strategic planners, helping their clients create and maintain wealth. The trend is to outsource the management of investments to specialist firms with extensive in-house research departments.

Lastly, it is good to recall Sir John Templeton's Investment Maxim Number 7: *The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell.* ¹

About the author



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