

Keeping your nerve in turbulent times.

July 2008

In an interview given to the Daily Telegraph online, Anthony Bolton looks at what investors should be doing amid the market turmoil.

As I have feared for some time, we are now in the middle of a full-blown bear market. As I speak, the FTSE 100 Index is down 19% over the past 12 months¹ and the consensus in markets is that things might well get worse before they get better. So what advice would I give to the private investor?

Let me first say these are my personal views. My recommendation is not to attempt to time markets but to take a long-term view. History has shown that the patient investor has been rewarded by the long-term upward trend in equity prices. Trying to switch in and out of the stock market is very difficult and most investors who try it are worse off as a result.

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A stake of £1,000 invested in the UK stock market 15 years ago and left



untouched would today be worth £3,261, assuming you reinvested the dividends. Our research shows that if you had missed the ten best days in the market since June 1993, then the stake would be worth a great deal less – £2,147. Strip out the best 40 days and that portfolio would have a value of only £885.²

If you find it difficult to stay invested in the bear market and are panicked by the bad news that is always around at such times, then perhaps equity investing is not right for you. The first rule of investment is: understanding yourself and your own temperament.

Those of you who do want to try to time the market, despite my advice above, should bear in mind that the outlook will deteriorate further as the market sinks lower. You mustn’t get more bearish as the market falls. At the bottom of the market the outlook will appear worst of all. This is just when the pressure is greatest – the point of maximum capitulation – and you may feel like quitting equity investment for good.

For those happy to remain invested, where should they put their money? Here my advice is to focus on large, good quality companies. Avoid at all costs smaller and medium-sized companies with weak balance sheets. Usually the mistakes I have made in more than 30 years as a fund manager have concerned companies with poor finances. Balance sheet strength is particularly important at times like these. If we enter a recession, then the strongest companies are those most likely to survive. I am expecting many more rights issues and a few company failures.

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In terms of which sectors to focus on, this is where some might regard my views as controversial. This bear market started with financial stocks and in particular the banks. It then moved to embrace consumer cyclical companies such as retailers and house-builders. Most recently it has started to affect some industrial companies and I believe the next stage after that will be commodity stocks which have done so well so far. I don’t think this bear market will have come to its conclusion without pulling down the commodity-related stocks.

I therefore have been advocating a switch out of commodity stocks into a basket of shares in banking groups which have already had their rights issues. This strategy will take patience: I often take a two-year view on an individual stock which I believe to be mis-valued because you can never be sure when the catalyst for a revaluation will take place.

Another reasonably attractive and safe area is the pharmaceutical sector, which has traditionally been viewed as a haven in difficult markets. This time around it has held up better than other sectors. Year-to-date, pharmaceutical stocks

have dropped by 4.7% against a market decline of 16.8% and over three months the sector is up 4.6%.³

What about emerging markets? Well, I do believe that they represent good long-term investments but I do not believe they will be immune from the slow-down in western economies in the near-term. We have begun to see this in the last few months, along with the impact of profit-taking by investors.

Finally, I'd point out that the worst mistake a private investor can make is to be sucked into markets when they are high and the prevailing mood is

the most optimistic, only to then get shaken out at times like this when prices are falling and the outlook is uncertain. It normally takes many years to recover from this experience. Please don't let this happen to you.

The good news is that I believe we are well over half way through the current bear market and a patient investor taking a two to three year view should be well rewarded by putting money into selected areas of the market over the next few months or buying a good fund. Remember that the stock market will turn well before there are any signs that the economy is improving.

Sources: 1 Financial Times 8 July 2007 to 8 July 2008. 2 Datastream 30/06/2003 - 30/06/2008. 3 Kleinwort Dresdner July 2008.

Stockmarket performance over the last 5 years					
	July 03 – July 04 %	July 04 – July 05 %	July 05 – July 06 %	July 06 – July 07 %	July 07 – July 08 %
FTSE 100 Index	10.7	14.5	14.1	13.3	-14.9
FTSE All Share Index	13.1	14.9	15.9	14.7	-16.1
Pharmaceutical sector	-3.2	11.1	20.7	-12.8	-17.9

Source: Datastream, as at 30/06/08. Pharmaceutical sector sourced from RIMES

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