



# Cavendish Medical

## BULL OR BEAR?

Are you betting on the green shoots of recovery or the end of the capitalist system? A casual observer of any of the more reliable financial media sources could not help but be confused by the apparent indecision of the world's economic "experts." It seems today that the only certainty is continued uncertainty.

However, there is no doubt that "investor sentiment" has improved, albeit from a very low level. This has been reflected in the recent UK stockmarket rally from the beginning of 2009. According to Capita Registrars<sup>1</sup>, May was the eighth consecutive month where private investors bought more shares than they sold.

So where is the source of this unfounded optimism? No doubt the Government and HM Treasury would have us believe that this is entirely the result of co-ordinated action, what has been described as "quantitative easing" or "printing money," where financial assets are purchased on behalf of the taxpayer in an attempt to put a floor under prices.

Financial economists are more likely to suggest that, as the number of buyers and sellers of shares in any market has to be equal, a market recovery is simply due to natural investor behaviour. The stock market is described as being a "forward indicator" where the question is always "what is my expected return?" It is evident now that share prices had declined to the point where investors' expectations about future returns were unrealistically low and had to improve, the point in a cycle called - by Warren Buffet and others - as "the bottom of the market." Only in hindsight will we know who was right and who was wrong.

Nevertheless, after any adverse event, and in particular an event of the magnitude of 2008, caution and risk aversion can easily become the default position. In order to understand whether what happened in 2008 was "unprecedented" one has to cast an eye back over many years from the present day to 1926 in the U.S. (the longest data series available).

In the U.S. the return for the market<sup>2</sup> in 2008 was -38.3% which was the second lowest calendar year return in the past 83 years, where only 1931 was lower at -44.4%. Thus, the large loss for 2008 is unusual, but not out of bounds. On the positive side, the annual market return is greater than 30% in 15 individual calendar years to 2009.

Are there any lessons to be learned from 2008?

Diversification is the only free lunch when it comes to investment. Shareholders in any one of a number of UK financial institutions (RBS, HBOS, etc) will tell you that holding individual shares is riskier than holding the market through an index fund.

Risk and return are related. "Guaranteed" returns of 10% per annum are revealed for what they were - a criminal fabrication by characters like Bernard "Madoff with the money" and Allen "the cricketing billionaire" Stanford.

Investment is for the long term and requires discipline. The long term numbers still suggest that there is a demonstrable "premium" for investing in shares in the US of 7.64% per annum. This "premium" is the excess return available for investing in shares rather than<sup>i</sup> the risk-free return available from holding cash deposits. This is the compensation for accepting the inherent short-term volatility that goes with equity investment.

If you would like further information, or help with your own financial plan, please email:

[simon.bruce@cavendishmedical.com](mailto:simon.bruce@cavendishmedical.com) or telephone: 0207 636 7006.

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<sup>1</sup> Matthew Vincent, FT Weekend 30/06/09.

<sup>2</sup> The "market" in this instance is defined as the CRSP Value Weighted Index, provided by the Center for Research in Security Prices at the University of Chicago. With permission from Dimensional Fund Advisors.

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