6 October 2011

Why Stay Invested?

September was a difficult month for equity investors. Global stock exchanges entered bear market territory for the first time in since 2008. Coming out of the summer months, the global stock markets were already jittery because of weak economic growth, US fiscal challenges, fear of recession, and European debt problems. So it didn`t take much in the way of bad news to cause markets to plummet in the month of September.

The major focal point of investor anxiety is the inability of the Euro nations to reach a consensus on how to resolve Greece`s debt problems.

The reality of the situation is quite clear. Greece has no option but to default on some of its debt as it simply not able to sustain the current debt level. The challenge is how to deal with the eminent default. European banks have significant exposure to Greek debt, and a number of these institutions cannot survive a Greek default without some form of government financial support. So fundamentally the issue is how to spread the pain of a Greek default. And the pain of default may not be restricted to just Greek debt. A number of other European countries have to a lesser extent similar debt problems.

In addition to the European sovereign debt problems, the failure of western governments to take decisive action to fix their economies also weighed heavily on the markets. Both Europe and the U.S. have serious fiscal problems and their respective governments seem to be muddling through those problems, taking the path of least (political) resistance, instead of taking decisive actions such as raising taxes (U.S.) or arranging for an orderly default (Greece) on their unsustainable debt.

On the positive side, these problems are largely political in nature, which means that with some decisive political leadership, market sentiment can change dramatically, and in a very short period of time.

The good news is we are likely very close to the bottom, and that the worst is hopefully behind us.

European governments are getting more serious about addressing the sovereign debt issues as the deadline for Greece`s next installment of bailout money is fast approaching, and there seems to be little political appetite to throw good money after bad. Greece admitted earlier this week that it did not meet all of the austerity targets that were set as a precondition to the bailout funds. This is actually good news as it will force a resolution to the Greek debt crisis.

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And while there are still some concerns about a recession, these concerns now seems to be centered mostly in Europe, as the likelihood of a recession in the US now seems to have abated.

In our last market communiqué, we cautioned investors that markets would likely be volatile in the near term – and the markets most certainly did not disappoint us. We are now cautiously optimistic that we are at or near the bottom.

Why should we stay invested?

We recognize that it may be difficult to watch the value of your portfolio drop in a down market, but staying invested with a well-balanced portfolio is the best strategy. It is also the only way to ensure that you participate during the market recovery.

We don`t know the exact date the stock market will hit bottom. This is a magic date because stocks often post substantial gains coming out of a bear market and the biggest percentage increases often happen early in the rebound. The rebound usually doesn't correspond with an upturn in the economy, but often precedes it. The market always looks forward.

When the true rebound comes, it may be hard to identify. It's actually fairly easy to spot - about three months after it happens. Of course, that information three months after the fact isn't very useful, but it points up an important consideration. Cashing out and trying to time the bottom of the market is a guessing game at best and not a way to invest your money.

The securities markets pay a risk premium commonly referred to as the "upside". You have to have your money invested to be paid this premium. Cashing out and sitting on the sidelines waiting to jump in when things seem safe simply does not work.

Earlier this week, the markets were down significantly. However, in the last two days, the markets are up almost 5%, and who knows how the week will end. What we do know is that sticking to your asset allocation was psychologically no easier 20 years ago than it is today. The point: We've experienced 17 recessions since World War II coupled with numerous bear markets; but, we have also experienced 17 recoveries and even more numerous bull markets. Over the years, the reasons for each downturn and recovery have been different. What we are currently experiencing is psychologically no different than before. Your best strategy is to stay invested during downturns and in this way you can't miss the bottom of the market and the subsequent gains on the upside.

Regards,

Ryan Lamontagne Inc.