

Pegasus' View on Markets 3rd Quarter 2008

by Yvonne Staples 1 November 2008

In July we wrote that we felt that there would be more volatility to come in the markets but that a rally would be forthcoming by year end. Little did we know what there was to come....

Market volatility reached a peak on September 29th in the minutes and hours following the US congress voting against accepting the proposed "bailout" package. The highest levels since 2002 were recorded, only being beaten twice this decade. We saw declines of 8.87% on that one day, not seen since October 1987 when we experienced "Black Monday", followed by a rally of 5.49% the following day. Many people have started to suggest that we have returned to the levels seen in the recession of 1929, and yet there has been even more treacherous conditions experienced even since then outside of the financial sector.

We have seen individual moves in the stocks of major companies of extreme size and volume, heightened by fear and panic, with investors rapidly dumping any stocks where there was any sign of weakness or negativity. Couple this with falling property prices, failing banks and low yields on government bonds and the effect has been devastating on many clients portfolios. Luckily our clients have been well diversified between managers and asset classes, thus protecting them from a large part of the downside.

We have also witnessed investors with a dilemma of where to put their cash, with bank failures in Europe being of uppermost concern for them. Unprecedented buying of UK and US Treasuries saw the yield returning less than bank rates and in the US returning a negative yield, as they panicked and bought Treasuries to ensure capital protection.

Even the stalwarts, materials and commodity stocks, have come under pressure. We have seen the price of oil rise to \$150 and then back down again to new lows of \$62. All of the Managers feel that oil and gold will be a safe haven moving forward.

Our review of our Managers has produced a mixed reaction to the markets, with some managers coming out of equities completely and finding a safe haven in cash and T-Bills, whilst others have "stuck to their guns" and kept their equity exposure. The former believe that a rally will come, however we will have to see new lows re-visited before they believe the bottom has been reached. The latter, although wishing that they had sold off some of their positions earlier, now believe is not the time to capitulate and sell, as the "bottom" is here and large rises may be experienced very rapidly.

All the Managers believe there needs to be further reductions on interest rates worldwide to have an effect on the global economy. Despite there being one rate cut in the UK of .50bps this has not been sufficient to make any impact and further cuts are needed and quickly.

We are currently in a climate where lenders can't lend and borrowers can't or won't borrow. Whilst rate cuts has worked in America, Europe is not America, and Europe have a more direct approach to managing its banking crisis, using taxpayers' money to prop up ailing businesses and this may afford us a more sustainable turnaround. China are showing a clear shift in their policy and for some time its leaders have been talking about the need to promote domestic consumption to reduce its reliance on export-led growth. China can do a lot to help matters; increase fiscal spending, tax cuts and easing of credit restrictions. Like Europe, China related shares are looking much more attractive.

It is important, though, to retain a sense of proportion amongst all this doom and gloom. Equity markets are already stabilizing. Chinese, Indian and European markets are improving and American markets have recovered a large proportion of its big fall.

If equities are held it is too late to reduce them and a long-term hold is advocated as we would expect to see a rally over the next 12 months. We continue to advise our clients not to panic as they are in the main, holding a defensive spread of investments, with most Managers holding a decent weighting in cash and positioning themselves ready for re-investment in the not too distant future.

Mark Twain wrote; *"October: This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August and February."*

I think that 2008 has proved to be such a year, however we look forward to the outcome of the American Election and hope that Mark Twain's philosophy proves wrong and that the remainder of 2008 and 2009 prove to be better years.