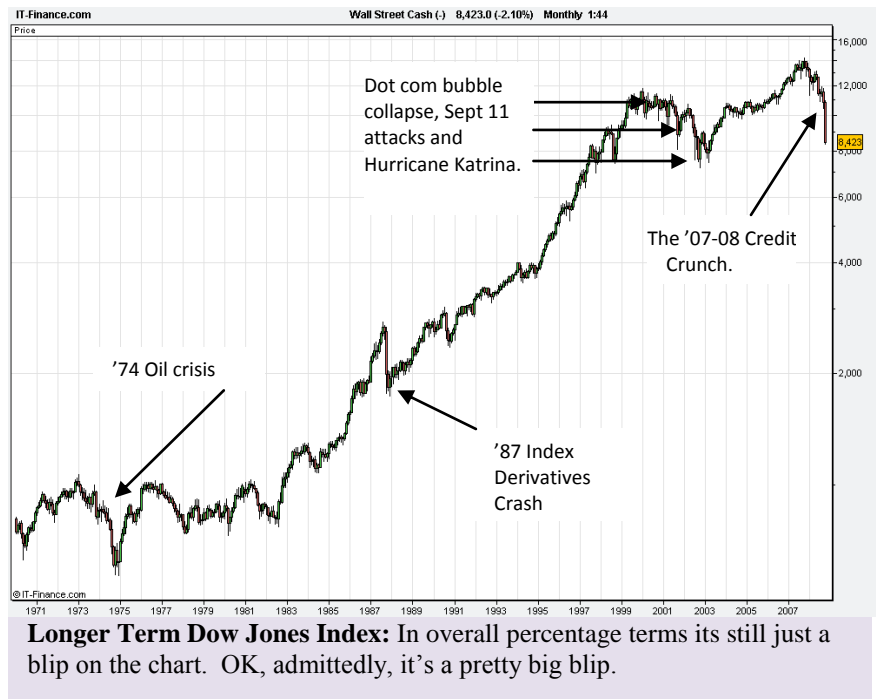


## Market Update (Summary)

OK, it's bad, but it's not THAT bad!

Some key points from our Wealth Management Team:

- We are now of the view that this is definitely NOT THE TIME TO SELL;
- On fundamental measures, **Australian** equities (shares) are undervalued and on technical measures, oversold;
- For most people, we would recommend waiting for markets to settle down before buying;
- Equities might go lower, but when they come out of this bear market, the first and second rallies will be where most of the rewards are for investors over the next five years;
- This is one of the sharper bear markets in our lifetimes, but still not the largest, and certainly not the longest;
- Economically, things look weak in America, but not as dire as some previous crises in our lifetime. Last financial year the US recorded economic growth of 2.8%. In the Oil crisis of 1973-75 US GDP fell by nearly 5% in total.



Its not the downward moves we want you to focus on in the graph above, **it is the recovery after** each of these fast downward moves. In each case, most of the bear market losses are made up within the first few months (and a fair bit of this within the first few days). This is why it is definitely not the time to sell. Most of the losses made on the sharp dips during this period were made up very quickly.

Obviously, this scenario has different implications for investors of different ages, and investment capacities. Contact us if you want to know how it might apply to you.

**Important Note:** Most investment portfolios will not be as badly affected as the headline index movements. Active fund managers would have been increasing bond and cash weightings over the last twelve months whilst equities have been falling. As interest rates fall, bond prices rise, cushioning most managed funds from the worst of the selloff in equities.

**“Don't Panic!” doesn't mean “don't do anything”**

For some investors, this market shakeup will have real effects on their wealth and plans for retirement. Usually selling after a long downtrend is the wrong strategy, but one that tempts even experienced investors. If you think that this downturn might affect your plans, or perhaps it has shown the weaknesses of a particular strategy adopted in your current financial plan, contact us so that we can look at **all** the strategies that are available to you to protect your wealth and enhance your future income. Putting some exact figures on where you stand will also ease some of the anxiety that the overheated media coverage can generate.

*This information is of a general nature only and has been provided without taking account of your objectives, financial situation or needs. Because of this, we recommend you consider, with or without the assistance of a financial adviser, whether the information is appropriate in light of your particular needs and circumstances.*

# The D Word, and why we Don't think so....

Towards the bottom of every bear market, the D word regularly gets trotted out (**Depression**).

Lets first be clear that there is not a direct link between equity market downturns and depressions. Equity markets in global history have quite often fallen to very low levels without causing a depression, but often forecasting long recessions. Historically, the indirect link has usually been one of confidence, but sometimes something more fundamental such as a supply constraint (eg: OPEC embargoed oil exports for a time in 1974, causing the price of oil to skyrocket).

## Why don't depressions occur anymore?

They still do, just ask anybody who lives in Zimbabwe.

They rarely occur in stable democracies with independent public treasuries and reserve bank structures. The reason they don't occur commonly in these situations is that the causes and cures of depressions are known and can be avoided provided the right responses are made by government. The US government (albeit with a reluctant Congress), is doing the things necessary to avoid a depression.

GDP between 1973 and 1975 fell nearly 5% as a result of the oil crisis. In this downturn the US has recorded annual real GDP growth of 2.8%, so the real economy effects are for more muted than the financial market commentary would suggest. The fear is that GDP growth will turn negative in the US in the future, and it might, but Depression depths? Not on the strength of the data available.

## So what has changed since 1930?

Prior to 1930, when economic activity slowed, government's typically responded by restraining expenditure in response to lower revenues generated by declining business activity. This exacerbated ordinary economic slowdowns, causing depressions. So the first

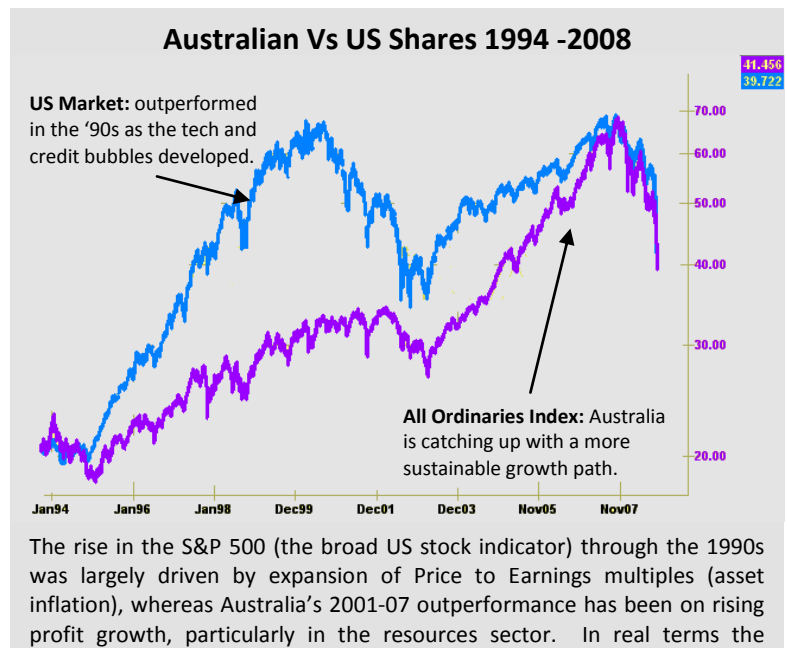
plank in ensuring the US and the rest of the world avoiding a depression this time around was the fiscal stimulus package that directly distributed money to all American households back in June.

In 1930, after many years of stock market growth and wealth generation for banks and investment houses, the failure of these institutions was seen as fair measure for the profits they had made in earlier years. As deposit taking institutions closed their doors and defaulted on deposits, the early response from the US government of the time was a laissez faire approach (let the market sort itself out). Two factors were at play here: the previous economic boom gave the government too much confidence in the market's ability to solve all ills; and there was a failure to protect participants at the less adventurous end of the market (bank account deposit holders) from the adventurousness of the directors that ran these institutions. By contrast, today US (and now Australian) depositors have access to schemes guaranteeing savings accounts. This prevents mass panic reducing deposits, which would further erode banks' capacity to lend.

Further, the provision by US Congress to provide \$700 billion in funding to buy mortgage backed securities is providing an amnesty for banks to come clean with the bad loans they have taken. It isn't designed to prop up these banks, although this might be a side effect, **it is to ensure that all other banks know where the bad loans are so that they are confident to lend to other banks.** At the moment the size of the freeze up in world credit markets far exceeds the total loan book of US mortgages.

## A Tale of Two Markets

Its not that we think the picture is all rosy, with the US in particular facing a long hangover caused by asset inflation coupled with a consumption-based economy overly reliant on debt. But the US is not the driver of world growth it was in 1929. Our eyes are on China and India to see that the easing in US demand does not have greater than expected knock-on effects. We still believe that Australian companies are probably the best placed amongst developed economies to take advantage of the growth in Intra-Asian trade, which we think will be largely unaffected by this current crisis.



*Gorrell Long Robertson  
Wealth Management Research Team*