

OUTSIDE THE FLAGS

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October Fest

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Ever noticed how gamblers always tell you about their big wins but tend to keep their even bigger losses close to their chests? People who seek to finesse their entry and exit of financial markets are similar.

Going awfully quiet in recent days have been the analysts who a month ago were saying that it was the time to get out of risk assets. It seemed a good call at the time as global stock markets had suffered their worst quarter in nearly three years.

Pummelling confidence were a host of concerns, including the European sovereign debt crisis, signs that global growth was stalling, and a general lack of confidence in policymakers to take effective action to avoid another recession.

One chartist quoted by Dow Jones said the US market was breaking down in what could be a very nasty prelude to the fourth quarter.¹ The advice from the technical analysts was that investors needed to be extremely wary buying stocks in October.

Adding to the nerves were the now-routine reminders² to investors about October supposedly being the “scariest” month for shares, with two of the biggest crashes in history occurring in the tenth month of the year—in 1929 and 1987.

Now while further volatility may well still lay ahead, those who took that advice and bailed out of risky assets at the end of September might now be rueing their decision.

The US S&P 500 rose by nearly 11% in October, its largest monthly rise since 1991.³ That was the year that dance act C + C Music Factory was topping the pop charts and “The Silence of the Lambs” won Best Picture at the Academy Awards.

1. “MARKET TALK: Use Extreme Caution Buying Stocks,” Dow Jones Newswires, September 24, 2011.

2. “Share Jitters Deny US Rise,” Daily Telegraph, September 26, 2011.

3. “US Stocks Decline Amid Concern About European Funding,” Bloomberg, October 31, 2011.

But it wasn't just a US story. The MSCI All Country World Index rose by 10% in October in US dollar terms, its largest one-month rally since April 2009. In Australia, the S&P/ASX-200 gained 7.2% in local currency terms, its best one-month performance since July 2009.

What's more, among the biggest-gaining sectors in October were the financials, energy, and materials sectors, which all lagged in the defensive mood of the prior months.

These are significant upward movements that will have eased some pain for investors after five to six months of consecutive decline in equity markets, but not if you had listened to the advice of some of the Jeremiahs in the financial media.

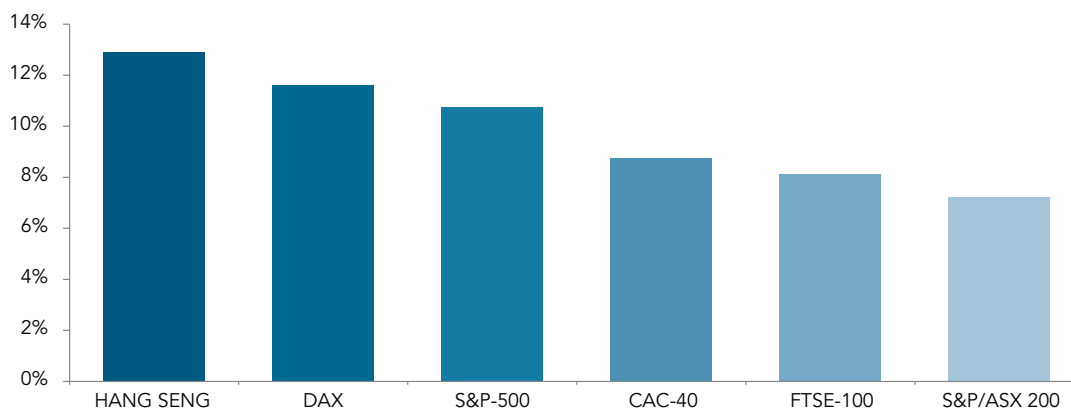
It's not often appreciated by ordinary investors that markets are forward looking. We know the news has been bad, but it's what comes next that counts. Selling out after a bad run in the markets just means you turn paper losses into real ones and leave yourself with the extremely difficult challenge of finessing your re-entry point. The reversal of direction in October highlights this difficulty.

We don't know if these October gains are sustainable—and already in November, sentiment around Europe has turned sour again. But we do know that markets can move quickly and respond to new information instantaneously. That's why market timing is so hard and why the best approach is to maintain your chosen asset allocation—with periodic rebalancing—irrespective of the week-to-week and month-to-month noise.

CHART 1

What October Effect?

Index Gains (Sept 30-Oct 31, 2011)



Source: Bloomberg, local currency terms



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