

## PROFESSIONALS' VIEW – NOVEMBER 2009

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### Humans Are A Strange Race (1):

Being human myself, I feel qualified to make such a statement, but for fairness' sake a little expansion may be beneficial.

I'll restrict any comments to our behaviour in terms of investing, as this is what this newsletter concerns itself with. Furthermore, we will look more specifically at statistics and forecasts.

Ah, forecasts. We all love a prediction. Each year we have "experts" predicting where the FTSE will be at the following year end; we hear economists predicting the next quarter's GDP figures and rate of growth; we hear them predicting when the next interest rate move will occur, and, if we're lucky, in which direction; we hear Governments predicting their levels of borrowing and how they will balance the books to justify it. We hear predictions constantly – and they tend to be as accurate as the astrological forecasts dispensed for a fiver by Gypsy Rose Lee in her caravan on Brighton Pier.

In his book "*The Black Swan*", Nassim Nicholas Taleb lets rip at "the empty suits."

"We act as though we can predict historical events...we produce thirty year projections of social security deficits and oil prices without realising that we cannot even predict these for next Summer. What is surprising is not the magnitude of our forecast errors, but our absence of awareness of it...certain professionals, while believing they are experts, are in fact not. Based on their empirical record, they do not know more about their subject than the general population, but they are much better than narrating. They are also more likely to wear a tie."

Whether Peter Geikie-Cobb, Christopher Lynas or Eric Holt (bond managers at Thames River, Smith & Williamson and Royal London respectively) wear ties is

something that I am unable to confirm just now, but each has been in the public domain making forecasts of late. "Disinflation and deflation is the risk" says Geikie-Cobb. "Deflation is the big risk in the next few years," agrees Lynas. "Rising VAT rates, fuel and utility bills could potentially increase inflation to 2-3% by next February," argues Holt [*Fund Strategy* October 26<sup>th</sup> 09]. Very different forecasts and someone will be more right than the other. But quite frankly, no one knows for sure how events are likely to pan out in the coming months. And these are just the things that we know we don't know. The most dangerous events are those that we don't know about – the very events that blow torpedo holes in the most confident of forecasts.

So perhaps it is safer to restrict investment decisions to facts that we recognise as being the case at present, whilst remaining ever-vigilant to the necessity to change one's mind as situations develop. This brings us neatly to....

### Humans Are A Strange Race (2):

Consider the following statements, all of which have been published during the final week of October.

Now that markets have risen sharply, "52% of active investors plan to increase their stockmarket exposure over the next few months, compared to 33% a year ago." [Source AIC Investor Confidence Research 26<sup>th</sup> October 09]. Logic would suggest that those who have missed the rally would be *more* cautious right now wouldn't it?

"85% of all invested money in mainstream pension funds is held in UK Gilts, bonds, shares and property" [*Citywire* 26<sup>th</sup> October 09]. As Matthew Morris of [howmuchdoineedtoiretire.co.uk](http://howmuchdoineedtoiretire.co.uk) points out, "what is the chance that the same country that you live in will be the one that produces the best returns?" Indeed, which makes the next set of figures even more baffling.

“A third of UK investors have no exposure to emerging markets despite the majority expecting the region to be the best performing over both the medium and longer term” [Professional Adviser 22<sup>nd</sup> October 09]. “45% of investors believe that the developing world will outperform all other regions over the next decade” yet “70% have less than 10% of their investments and pensions in emerging markets.” This appears to be totally irrational and can be seen to be rooted in the traditional beliefs regarding risk. Perceived wisdom states that emerging markets = high risk. Is it time to challenge this thinking?

In their book “*Misunderestimated – the new world economic order: time for a change in thinking*”, Bryan Collings and Marina Akopian certainly think so. Their case appears to be a strong one. They list their top ten forces behind the emerging market tailwind and these include:

1. Emerging markets represent approximately 75% of global land mass
2. Emerging markets represent over 80% of global population – one in every five people is Chinese [which reminds me of that joke: if this is true, one of my family is Chinese. I’m not sure if it’s me, my brother Alan, my Dad Colin, my Mum Susan, or my cousin Ling Chi Mao. Ed]
3. Emerging markets have over 90% of oil and gas reserves; 70% of global coal reserves; and in excess of 60% of global deposits of copper, nickel, iron ore and bauxite.
4. Emerging markets are becoming the largest consumer of commodities, driving the commodities “super-cycle”
5. Emerging markets hold 75% of the world’s total foreign exchange reserves
6. The external debt/GDP ratio in the UK is 400.7%, in the US 104.4%, and in Germany 127.8%. In China, India and Russia it is 10.2%, 19.8% and 29.5% respectively.

7. Combined imports to Brazil, Russia, China and India during the course of 2009 are estimated to surpass the US for the first time, significantly reducing the global economy’s dependency on the US consumer.

And so on.

Maybe we don’t need forecasters to tell us where economies are headed. Maybe we just need to take the clues that are out there and put two and two together. Quite why we, as a nation of investors in general, cling on to the belief that the UK is somehow a safer place to invest – and hold such store in this belief that our very future is invested in a distorted way through the common pension fund in UK assets – is not immediately clear. Predictions, as we’ve seen, often come down to luck. Someone will always predict correctly. If they do, they should be wary of taking too much credit for doing so.

In our view it is probably more sensible to adjust our investments towards the new world order that appears to be taking shape, as patriotism when it comes to investments can often be misplaced. But then, as we’ve said throughout, we’re a strange race, we humans.

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