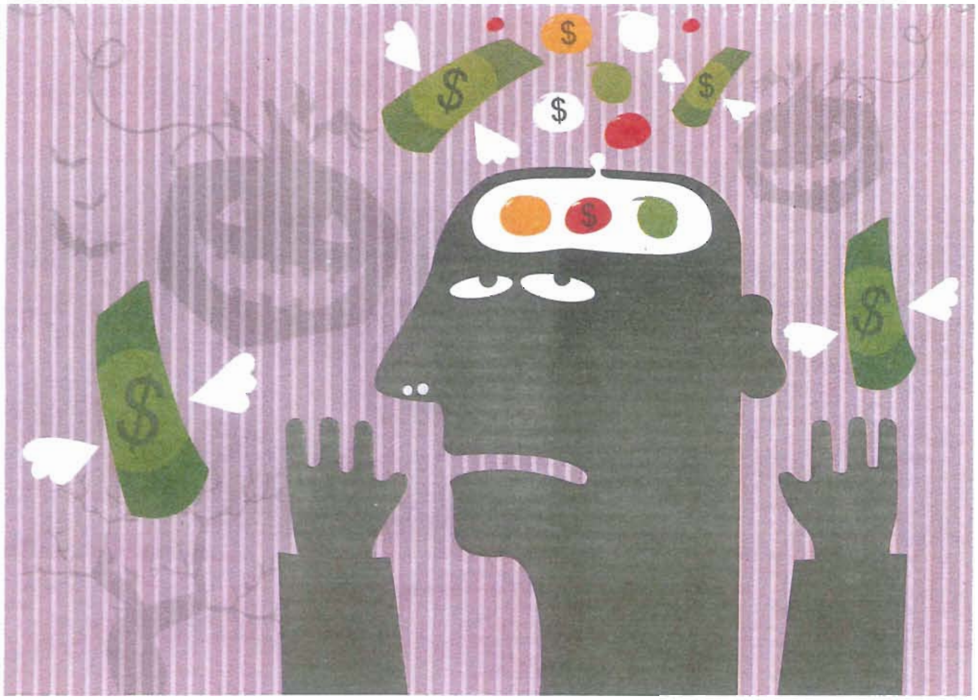
October's 'Peculiar Danger'

Investors tend to be particularly wary this time of year, **Colin Bloodworth** explains



Just a few days to go and we will be clear of the month that every investor dreads — October. Why is this so? History provides the answer. It is the month when things often go badly wrong.

Could it be due to the onset of winter in the northern hemisphere, with the prospect of months of dreary days and cold, dark nights ahead? Maybe the psychologists have an answer, but here are the facts. October was the month of the first major US banking crisis in 1907. It is also the anniversary of the 1929 crash that brought about the Great Depression and the 25th anniversary of 1987's "Black Monday," when global stocks were decimated. Still fresh in our minds is the credit crunch and banking meltdown that was at its zenith in October 2008.

But the markets don't crash every October, so why should we be worried this year? Well, there are a few worrying factors. Firstly, the markets have been creeping up nicely since their summer lows and without terribly good reason. Such rallies are often followed by corrections. Secondly, the big problems dogging the world's economies have not gone away. US debt is increasing, the euro debt crisis is far from resolved and the powerhouses of China and India are both slowing down. The United States is printing money at a frightening rate and other countries are likely to follow suit. Although interest rates are at record lows, inflation is creeping back.

So should we sell up and run for the hills?

Panic is never the best solution. The markets are still driven by sentiment and if people have reason to feel optimistic, stocks can go up whatever the fundamentals. While you can gain or lose money in the short term, the real success stories are those of people who take a long-term view.

A further consideration is that the stock markets still represent the core of the capitalist system and should protect your wealth in the long term, provided you hold a diversified range of stocks. Focusing on just one or two stocks is highly dangerous. Even focusing on just one market can be risky.

Diversification is the best protection

While we tend to think in terms of stocks when we talk about investing, there is a whole world of asset classes and products that are uncorrelated or only slightly correlated with stock markets. A sound investment portfolio may contain less than 50 percent in stocks, with the remainder invested in bonds, gold and precious metals, natural resources including oil and water, forestry, asset-backed lending, hedge funds and a host of other alternative strategies. Such investments do require care and proper advice though. With such a portfolio, a 20 percent crash in the stock markets would likely result in a portfolio hit of only 10 percent and probably less as some assets such as gold often rise in value when stock markets fall.

50%

the proportion of a sound investment portfolio that is made up of stocks, according to Colin Bloodworth

How to avoid losing sleep

The first rule is that you do not invest in any product unless you are prepared to accept that there might be short-term losses, in which case you calmly remain invested until it recovers. Secondly, if you are going to invest in any speculative stocks or other investments that offer high returns, you do so only with money you can afford to lose in the worst case scenario. Despite the miserable current interest rates, you must always maintain a high level of liquidity so that you never have to sell an investment to raise emergency cash. If you do, it will almost certainly be at a time when markets are also in distress.

Finally, if you are still worried about the remaining days of October, the following quote from Mark Twain should put things into perspective:

"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."

Colin Bloodworth, director of PPI Indonesia, has spent over 20 years in Indonesia. If you have any questions on this or a related subject, you can contact the writer at indonesia@ppi-advisory.com