MARKET UPDATE

What does the Fed's approval of the $US 700bn bailout mean for investors?

What exactly is "the bailout"?

Firstly is it accurate to describe the Federal Reserves injection of liquidity as a "bailout"? More correctly, it is an initiative designed to assist credit markets to function with more confidence, thereby easing the concerns with respect to how banks lend to each other. A "bailout" would imply that it is something for nothing and this is not the case. As the week's political machinations have demonstrated, there is a strong view that if US taxpayer money is going to be used to assist financial institutions, the taxpayer should be in a position to benefit from such interventions, either from price appreciation in the assets which the Fed purchases, or by virtue of equity positions it takes in organisations that require assistance.

The international banking crisis will continue to present significant challenges until the US and UK housing markets stop declining in value. Ensuring banks are able to lend on housing appropriately is an important step in that process.

So the passing of the bill through Congress is a good start, but it is just a start.

So what is important for investors at this time?

For both new and existing clients there are several principals being followed in how and where their funds are invested.

1. Diversification is the key to capital protection - diversification within and across asset classes, sectors and economies.
2. Within the banking sector, diversifying how deposits are held.
3. Holding more cash than usual within portfolios.
4. Ensuring that lifestyle (spending) needs can be safeguarded over the next 3-5 years.
5. Being mindful that interest rates will decline rapidly over the next 12 months in NZ. Taking duration risk therefore is an appropriate method of portfolio protection for the right quality of assets.
6. Owning shares in companies producing "real" goods and services, even if they do go down in value, they are likely to be better placed to have money than a bank deposit if the banking crisis worsens. Current equity prices have already been heavily discounted. Therefore they are likely to look a very good investment in the medium term.
7. Protective mechanisms have been put on equity portfolios to ensure if equity markets drop further from this point, then clients will be well protected from those declines in value.

At the end of the day, our interests are aligned with our clients, in ensuring that the value of their portfolio grows wherever and whenever possible. We are however mindful in order to achieve growth over the medium to long term, we need to take a medium to long term view.

A short term focus at this time could well do more harm than good to clients' wealth.