NEWSFLASH

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18 March 2008 Candice Paine: Glacier Research

The FED's not panicking, and neither should you.

Yesterday (Monday 17th) was a remarkable day for global stock markets. At one stage the All Share was down over 4% and Financials down over 6%. The market recovered somewhat towards the end of the day to close just over 2% down. The sudden fall and partial recovery was driven by the near-collapse of Bear Stearns – the fifth largest US Investment Bank.

Bear Stearns is the latest casualty of the deepening US mortgage crises. Without help, it would have gone bankrupt. The Federal Reserve and JP Morgan thrashed out a deal over the weekend to prevent the chaotic outcome Bear Stearns bankruptcy would cause to the financial system (where Bear Stearns is a counterparty to many financial transactions).
The result was JP Morgan taking over Bear Stearns at $2 a share (Bear Stearns was trading at $30 a share on Friday, and over $150 a share one year ago). At the same time the FED gave JP Morgan an additional line of credit, and eased the discount rate (the rate the FED lends to banks) by 0.25%. Further, analysts are predicting that the FED will cut the FED funds rate by as much as 1% during its scheduled meeting today.

The market initially reacted badly to the news – it had not anticipated that Bear Stearns was in such difficulties (the share was at $30 on Friday after all), nor that the financial system was so close to paralysis. But increasingly the market is realizing the FED is doing all in its power to enable an orderly adjustment of the financial system – hence the recovery in the local market, and the US market actually ending positive for the day.

Over many years, the US financial system has spawned many, very large financial institutions which through a combination of favourable market conditions and increasingly complex security structures have become so interconnected that the health of one of these giants almost certainly impacts on the well being of the others (including South African financial institutions with no direct sub-prime exposure). At the same time what started out as a liquidity crisis is fast becoming a solvency issue and the FED has stepped in to stem this tide as best it can.

There undoubtedly will be a number of further difficulties from the sub-prime crisis. Another financial institution might need to be bailed out. However, the FED Reserve has shown its commitment to keeping the system functional.
It is almost certain that US economy is in a recession, but it is yet to be seen how long and protracted this slowdown will be. Global investors have reacted with increased selling across all stock markets and the USD has lost significant ground against all major, developed market currencies.

What should investor's do? The rising market volatility is making many investors very nervous. It would appear that there are few safe havens and that most securities are not showing much immunity to the economic fallout from the US. Sane words about sitting tight and riding the storm are not much comfort either when capital values change ever hour with the vagaries of the market.

At Glacier Research we believe that if you have a well diversified portfolio which is in line with your personal risk appetite then your investment should be able to weather this period of market volatility and any others like it. This is not a time to panic. Selling equities now means that you bank any losses you may have experienced. It is time to stick to your disciplined investment approach because your personal goals and objectives have not changed and your existing portfolio is still designed to meet those needs.