

## Amid worldwide economic uncertainty, Paul Farrow asks the professionals how investors can protect themselves

**G**lobal stock markets are gripped by fear as investors fret over the world economy. The "Fear Index", as the Chicago Board Options Exchange Volatility Index (Vix) is popularly known, is rising – this week it hit its highest level since the height of the financial crisis in 2008.

The Vix, which is the subject of the latest Robert Harris thriller, *The Fear Index*, tends to rise when stocks fall. The index measures the cost of options that are bought to insure against equity losses, and its high level indicates how worried professional investors are about more share price falls.

The measure rose above 80 during the worst of the 2008 financial crisis and was back in the mid-forties this week. According to Jim Strugger, a strategist at MKM Partners based in America, a Vix rising above 48 would signal that the volatile trading environment was "advancing to a new, higher-magnitude state that could last into early 2012".

Stock markets worldwide, including London's FTSE 100, dipped sharply at the beginning of the week as fears over the global debt crisis refused to disappear. Britain's blue-chip index fell below the 5,000 barrier on several occasions as investors lost their nerve. Investment into cash and money market funds more than doubled in the third quarter of the year on one of the UK's biggest fund buying platforms, Skandia.

The FTSE regained some lost ground midweek, but few commentators believe we are out of the woods. When the Bank of England Governor, Sir Mervyn King, said late on Thursday that the financial crisis could be "the most serious we've ever seen since the Great Depression of the Thirties, if not ever", he ensured that the fear factor was here to stay, at least for a while yet.

### What should investors do?

Stock markets are driven by fear and greed – and fear is the name of the game right now. It is why many private investors have been avoiding equities in recent months.

But many investment experts advise that, as hard as it might be, investors should be rational, focus on the long term and, most of all, remain calm.

Market turmoil and volatility have a strong effect on the psyche of investors. Decision-making becomes dominated by emotional responses, rather than reasoned thinking.

Greg Davies, the head of behavioural finance at Barclays Wealth, said too many investors started focusing on the short term and forgot that, in the long term, investors were earning a premium for taking risk, particularly if they bought, rather than sold, when markets were low.

Mr Davies said: "Think long-term, think big picture, do less than you're inclined to. In the long term we earn a premium for taking diversified investment risk, but we have to make it through the short term. Right now markets are pricing in not just risk but the anxiety that events have induced in investors. If you can overcome this anxiety and forget about short-term market movements, you'll earn this anxiety premium by buying closer to the bottom."

Advisers urge investors not to try to time the market – on either the way in or the way out – because not even the professionals have a clue which direction markets are

heading. Investors should focus on their investment goals and on what they are trying to achieve with their savings.

Shane Mullins, managing director of Fiscal Engineers, is another who strongly believes that investors must hold their nerve because they "can't avoid equities" if they want reasonable returns over the long term. His advice is to be realistic with your expectations and review your investment goals.

If they are off target, this might mean altering your time horizon, or acting counter-intuitively and investing in equities on the dips. "Fear and trauma lead investors to do two things: they look at what they would have got had they stayed invested in cash and they move into a defensive position too late," Mr Mullins said.

### What are your safe options?

Corporate bonds used to be a shoo-in for safe-haven investors, but the financial crisis has caused fixed-interest markets to wobble. Kevin Corrigan of Lombard Odier Investment Managers suggested that "canny" investors might instead seek out corporate bond funds that have avoided the banks, and which instead have bought bonds issued by solid, cash-generative and cash-rich industrial businesses.

He said: "Why lend to the German government for 10 years and receive 1.7pc a year when you can lend to Wal-Mart at 3.6pc or to EDF at 4.7pc, both of which are just getting on running their businesses?"

Corporate bond funds that top advisers' buy lists include Invesco Perpetual Corporate Bond, Artemis Strategic Income and Standard Life Higher Income.

Peter Lawery, a manager of the Jupiter Independent Funds team, said investors should be wary of holding cash, as it is almost guaranteed to deliver negative real returns. "Return of capital is more important than return on capital so we prefer holding high-quality equity income funds such as Invesco Perpetual High Income, which invest in businesses that will pay out decent dividends even when the market is depressed."

### Opportunities amid the rubble

You can bet that braver investors are waiting for an opportunity to snap up some bargains – decent companies whose share prices have been dragged down with the rest. Rob Burgeman of Brewin Dolphin, the stockbroker, is not convinced that now is the right time to dive back in – "it's too early" – although he suggested that some stocks looked good value.

James Sullivan, co-manager of CF Miton Special Situations and Strategic Portfolios, said: "After the recent weakness in equity markets, valuations are beginning to more accurately reflect the uncertain backdrop to equity investing. This presents an opportunity to selectively collect some quality companies that are notably cheaper. He cites Invesco Perpetual UK Strategic Income and CF Lindsell Train UK Equity as two funds that could prosper.

Rupert Robinson, the chief executive of Schroders Private Banking, said: "As usual, good investments have been left stranded along with bad investments." He cited Rio Tinto shares, which traded at £45 earlier this year but recently touched £27, as ones that catch the eye.

Mr Robinson said: "The so-called 'Brics' [Brazil, Russia, India, China], having been excessively fashionable investment accessories, are now excessively unfashionable, like shoulder pads and big hair. India [down 30pc this year] and China stand out from the crowd, with resilient, strong growth, particularly relative to the developed world, and a habit of turning investors' heads the moment a note of calm returns."

But Mr Lawery is not so sure. He said: "There are opportunities to bottom-fish in riskier markets if you are investing on a five to 10-year view. However, investors need to ask themselves whether they believe a better opportunity might arise. We believe there might be."