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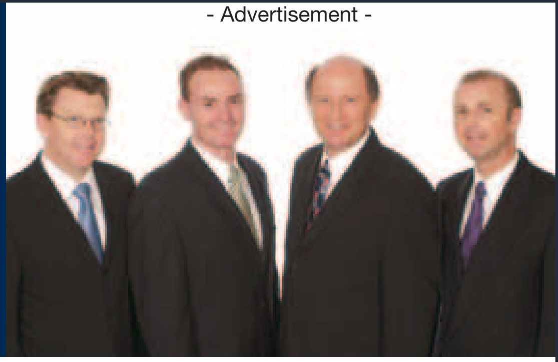

Ord Minnett Buderim

Is It Different This Time?

The catch cry in the bull market used to be 'stronger for longer' or 'this time it is different'. In reality, one finds it rarely is different. The same philosophy may also be applied to the current bear market and while words like 'unprecedented' and 'unparalleled' have been bandied around, one must wonder how different it really is this time to previous bear markets.

Prior international banking crises have all involved the failure or near failure of a raft of overseas banks. This has always had the flow on effect of a restriction in lending practices and a contraction of credit. In the US in the 1980's, the Savings and Loan crisis saw the failure of 2700 lending institutions. In the late 1800's a lending boom related to railroad overbuilding ended with 600 bank failures and a run on US gold supplies. These crises have been repeated time and time again, with over 15 banking crises in the last 130 years, or one every 9 years.

The core of each crisis has always revolved around overconfident investors who borrow heavily, assuming the prices will continue to rise. Each time the bubble bursts in a different way, but it is always the result of excessive borrowing and loose lending practices. The fallout from the bubble is usually characterised by loan defaults, damaged bank capital and a reduced ability / willingness to lend. It has almost always resulted in business grinding to a standstill and corporate earnings falling severely. Sound familiar?

Alliance Bernstein, a global funds manager, has undertaken some research that shows if the current crisis matches the average, then on an inflation adjusted basis, share markets might be expected to reach their previous peaks by 2016. While this may seem a long way off, it does imply the possibility of double digit returns from the world sharemarkets over the next seven years. The average results of prior crises would suggest write offs of $US5 trillion, or approx 20% of loans outstanding and US house prices falling by 50%. This adjustment has already occurred in stock markets and the US housing market, although nowhere near $US5 trillion has been written off yet.

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Governments worldwide are taking pro-active action to minimise the fallout from the crisis. In fact, the amount of government intervention is so large that it is history making. Unfortunately it may eventually lead to other problems such as long term inflation. The final outcome is unknown, and as the recession deepens it is possible that reduced household spending may threaten economic growth.

You cannot deny the world is in some form of recession. Australia is lagging this somewhat and is currently experiencing a milder form, which may worsen. What is difficult to know is how much of this is priced in to equity markets. What we do know is that at some stage there will be a recovery; and at some stage those in cash will have to invest or be forced to survive on negative real returns from cash after inflation is taken into account.

If you would like to discuss your situation, call Ords Buderim on 5430-4444.

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