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# Watson French

INDEPENDENT FINANCIAL PLANNING  
& INVESTMENT MANAGEMENT

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## **Red flag for equities as storm clouds gather**

**Standfirst:** Gathering clouds over equities markets point to a sharp correction and investors should look at taking profits, warns **Stephen Watson** of Watson French in Truro.

There's an old Wall Street axiom of 'sell in May and go away' when investors traditionally take flight from equities, and we've become used to the market nervousness that invariably follows.

But this May's nervousness has been exacerbated by worries over sovereign debt in Europe, a slowdown in China and India and the imminent end of the Federal Reserve's quantitative easing in the US later this month [June].

We often see a mid-summer rally, so equity market highs could occur as late as July. After that any rally will only continue if the Fed opts to carry on with another round of quantitative easing.

The upturn in equity values since March 2009 for the mature and developing economies is impressive. I believe this run is now coming to an end and a market top will occur soon. Consequently the second half of this year looks particularly risky.

It is essential to take a medium to long term (five years plus) view when capital is invested and generally speaking, hold the investment through the ups and downs of the market rather than trade in and out of investments.

However, there are occasions when it is wise to take profits and move to cash, wait for the markets to tumble, move back into investments and make a packet. Had you done this in 2008 and had the nerve to reinvest in February 2009 you would have made huge returns on your capital. If you did, I recommend you now move to cash and bank your profit.

Predicting the markets is a perilous activity but there are times when the combination of financial circumstances and investment market cycles gives strong warning signals. Without wishing to be alarmist, for the developed economies I believe we are looking at one of these times.

The UK Economy is struggling and cutbacks to reduce the deficit have not yet fully impacted on consumer spending. Interest rates look set to rise, possibly in August, and this will be hard for a variable rate debt-ridden population. Salaries have been frozen in the public sector and the private sector employers cannot afford salary increases. Disposable incomes and discretionary spending is under huge pressure.

More than 50% of citizens in the USA are now recipients rather than contributors to the tax system. The US Dollar is at a 40 year low point and prospects do not look good for overseas investors. Even if they make money on the US Stock Market they will lose on the currency.

The cyclically adjusted price/earnings ratio on Standard & Poor's index is 23.5. The index is useful in identifying extremes and has only been this high four times in the last 100 years – 1929, 1966, 1999 and October 2007. And it did not end well on those occasions.

The USA's money printing strategy has held the investment markets up. If they stop, share prices could experience a sharp fall.

I believe this combination of factors is to be seen as a red flag. Consequently unless something positive occurs and we have good reason to remain invested we will be recommending our clients move to cash at the end of July this year. The last time we made this recommendation was in 2008 just before recession and it served them well.

- Stephen Watson is Managing Director of Watson French, the Truro-based Chartered independent financial planning and investment management company with more than £100 million under management. [www.watsonfrench.co.uk](http://www.watsonfrench.co.uk)