

6th November 2008 – Lowest interest rates since 1955

Today the Bank of England announced cut in interest rates to bring the base rate down to 3%. A cut was widely predicted, but the magnitude of it – down by 1.5% – exceeded the expectations of all the “experts”, showing again, how quickly the business environment can change, and trying to second guess any significant market event is very difficult.

Bad news for savers relying on deposit interest

Overnight, those relying on interest from deposit savings will have seen their income drop by one-third, although it is expected that inflation will fall.

The rate of expected inflation is relatively easy to predict over the short term, as it is calculated from figures which are already known. We know the price of oil and other goods have fallen since the last inflation figures were calculated, so the next official figures will probably show falling inflation, but when analysts start telling us what longer term rates of inflation will be, we should be sceptical.

Market behaviour

The attempts to forecast longer term inflation have been poor in recent years. In fact, attempting to make money by relying on any financial forecasting will always be a struggle, as two quick examples will show.

M & S results

Earlier this week, Marks & Spencer announced that its profits were down by one-third. On the same day, the share price went up by 7%!

This serves as a reminder that stock markets are ‘forward thinking’ and are not priced only on what is known today but what is expected to happen tomorrow. The M & S share price had already taken a thumping in previous months. Analysts and commentators forecasted the results to be announced this week would be terrible. They were very bad, but not as bad as expected, and hence the share price went up.

Bank shares

Investors who followed tips to buy RBS or HBOS shares at the start of March 2007, when the shares looked a bargain, have now have lost almost 90% of their investment.

There is no such thing as a safe bet as risk and reward cannot be separated, but the academic world agrees that portfolio diversity is your greatest friend.

Too many investors attempt the impossible – of trying to pick the winning stocks, and it is a very difficult game to play. The evidence tells us that the day-to-day stock market movements really are beyond our comprehension.

It has not been mentioned much in the news, but in the last two weeks stock markets have moved up strongly from the low point on 27th October. During this short period there has not been any good economic news until the massive interest rate cut. Curiously, on the day the cut was announced and when many would have expected the market reaction to be positive, it was a poor day for shares.

For those of us who have invested in a diversified FTSE All Share tracker fund (as part of a diversified portfolio) during a difficult period, we still have most of our initial investment to participate in a recovery. Shares can come and go, but there will always be ‘a market’.