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Investment

Joanne Ellul reports that the rollercoaster really got going after the US downgrade

2011

Source of the volatile

Stockmarket volatility that has seen the FTSE 100 fluctuate between a low of 4,944 and a high of 6,091 has made for a tough investment market this year.

High levels of cash, sovereign bonds and safe-haven assets like gold made frequent appearances in investor portfolios and funds.

The twists and turns and conflicting political forces involved in the eurozone crisis were primary factors that caused volatility but another contributor was instability in the US.

The US raised its debt ceiling 17 per cent from $14.3trn to $16.7trn in August to avoid a default on debt obligations, leading Standard & Poor's to downgrade the US's America's credit rating from AAA to AA.

Advisers say this was the start of a period of sustained volatility that the market is yet to recover from.

Chelsea Financial Services head of investment products Matthew Woodbridge says: "Markets were resilient to the Japanese earthquake in March and the Arab spring that began at the end of last year but the S&P downgrade of the US, combined with the euro crisis, tipped markets into a period of sustained volatility. The downgrade increased already high levels of uncertainty and investor nervousness, contributing to volatility."

Bestinvest senior investment adviser Adrian Lowcock says: "The downgrade showed the lack of financial strength in the world's biggest economy. It sent stockmarkets tumbling and was the start of a period of uncertainty as European concerns returned with force and US economic data deteriorated. Investors are starting to learn that sovereign governments do not have unlimited resources."

Lowcock says this did not cause investors to rush for the exits, as they have become more steady in their response since the 2008 crisis.

He says: "Since the onset of volatility, we have seen investors top up on a range of assets from the more cautious bonds and equity income to Asia Pacific and emerging market equities, where investors use the low points in valuations as entry for long-term growth opportunities."

The gold price hit a record high in August at $1,900 an ounce and yields on US treasuries and gilts became depressed during the year as investors flocked to safe-haven assets.

Page Russell managing director Tim Page says this year saw a bubble in UK gilts and US treasuries but Western sovereign debt remains risky.

He says: "Despite the fact that clients phone me to talk about the visible volatility in equities, it is the so-called 'low-risk' fixed-income side of the portfolios that worry me. Gilt yields have been consistently at a level they have not been at since the Second World War, so correction is likely to happen and could leave clients who are trying to be defensive more vulnerable."

Investment Management Association figures show October net retail sales of £615m, a huge drop on the monthly average of £2.2bn for the first half.

Net retail sales to the end of October totalled £16.3bn, down by a third from 2010's £23.8bn.

Jonathan Davis Wealth Management managing director Jonathan Davis says: "The drop-off could be because advisers cannot persuade people to part with their money, as they are downbeat on the economy. It could be that people do not have enough money to invest."

The fund industry saw increased M&A activity. Henderson took over Gartmore in January, Australian fund firm BT Investment Management bought equity boutique JO Hambro Capital Management in July and Liontrust Asset Management bought emerging markets boutique Occam in August.

One of the big talking points was the IMA's managed sector review. It was slammed by fund managers and advisers in May when it said it planned to rename the active, balanced and cautious sectors as managed A, B and C, and create a new managed D peer group for the least risky managed funds.

After a prolonged consultation, it aligned itself with the Association of British Insurers' definitions last month.

The move sees the active, balanced and cautious sectors come under the ABI sector names.

The cautious sector will become the mixed investment sector 20-60 per cent shares, the balanced sector will become the mixed investment 40-85 per cent shares and the active managed sector will fall under the flexible investment sector banner, previously known as mixed investment 60-100 per cent shares under the ABI's terms.

The ABI also offers a mixed investment sector 0-35 per cent shares and this has been created in the IMA sectors.

The percentages indicate minimum and maximum exposure a fund manager can have in equities. The changes will come into effect from January 1, 2012. Firms have until April 2012 to make the changes to funds.

Hargreaves Lansdown investment manager Ben Yearsley says: "The new sector names are useful as there will be clear difference between the sectors on equity weighting."

On regulation, Informed Choice managing director Martin Bamford says the FSA emerged as a product regulator for the first time, with its guidance on traded life policy investments.

Last month, the FSA labelled life settlement funds as high-risk, toxic products and said it aims to ban TLPIs from being marketed to retail investors. Mass redemptions led to the closure of the EEA life settlements fund.

Bamford says: "We see the death bond guidance as a line being drawn in the sand by the FSA, which is likely to force advisers to go back to basics on investment advice processes."