

The 70s' revival

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With world markets in a state of instability and flux and the UK facing a severe recession, prudent investors should look to past downturns to gauge how to survive this crisis.

Many stocks are trading at historically low ratings and it may be a good time for the medium to long-term investor to buy. Similarities have been drawn with other downturns but the most relevant comparison of the current situation can be made with the market in 1973-75.

Banks suffered in the 1970s, just as they have now. In 1973, it was rumoured that both National Westminster and Midland Bank were on the brink of collapse.

The stockmarket index of the time, the 30 Share Index (or the FT30) dropped by over 70 per cent, sparked by a quadrupling in oil prices due to the Yom Kippur War.

The property markets plummeted and British Land saw its share price crash to just a few pence. Retailers suffered, although not as much as companies in today's market.

The resemblances stop there. The property market crashed in the 1970s after the Government imposed a commercial rent freeze, causing huge distortions in property valuations.

High interest rates made bank borrowing very expensive for businesses. When the rent freeze was lifted in December 1974, investors returned to the property market and developers recovered more quickly than they are likely to do today.

Although many property companies, such as British Land, relied on bank finance, most companies' balance sheets were not so highly geared and the companies were less dependent on debt finance.

In today's market, Capital & Regional is typical of many property companies at risk of faltering on loan and credit repayments. In the housebuilding sector, Taylor Wimpey is a similar company that has not resolved its funding issues.

Panic selling of equities happens each time there is a crisis in the markets as investors rush to redeem their money. This time around, hedge funds have exacerbated the situation.

Many have fallen foul of their high-risk, high-return strategies as increasingly risk-averse investors demand their money back, forcing funds to sell their holdings. The market for many hedge funds' products has disappeared. Funds facing redemptions are often unable to sell their most affected holdings, forcing them to meet withdrawals by selling quality stock, often in companies with strong balance sheets and good earnings prospects. Thus, the market as a whole is dragged down.

Mitchell & Butler and Sainsbury's are examples of companies where shareholders stake changed hands at a big discount to the market value following the Icelandic banking collapse.

On one level, the FT30 in the 1970s and today's FTSE100 cannot be directly compared.

Today, companies in trouble drop out of the FTSE indices at quarterly valuations, concealing a large part of the most dramatic falls. By contrast, in the 1970s, the sole index was the FT30. Constituents of the FT30 only changed at the FT editor's discretion, influenced by his financial and statistical cohorts. This was usually when there was a major event such as a merger or failure. In reality, the constituents rarely changed, exposing the full extent of major collapses.

There are several factors that may make this recession less severe than in the 1970s. At 3 per cent, interest rates are low, and likely to drop further, whereas in 1973-74 they were an eye-smarting 15 per cent. Consumer price inflation stands at 4.5 per cent now versus over 20 per cent in 1975. Stagflation was the risk in the 1970s, deflation is the worry this time around.

It is true that, in 1973, the market fell further than it has so far in the current cycle but share valuations at their peak in 2007 were far less stretched than 30 years ago. In the year from October 2007 to October 2008, the market fell by 43 per cent. At its peak, the FTSE was 6,730 and would therefore need to drop to 2,019 to be comparable with the fall in the 1970s and it is unlikely that it will drop this much.

Despite the prospect of a global recession, there are a large number of shares in strong companies, which have been dragged down by the market malaise to unjustifiably low levels.

Economic factors are now turning in favour of certain sectors. The cut in interest rates will be welcomed by business generally but especially by property companies as it will reduce the cost of servicing their debt.

The fall in oil and commodity prices will help manufacturing and the drop in the value of the pound will give exporters a boost and help sustain their earnings. The falling pound will give investors in companies that report in dollars, such as BP and Shell, more for their money than they expected.

There are rumoured to be several good takeover opportunities about to present themselves. Some undervalued oil stocks have been subject to takeover bids in recent months. In the UK, approaches have been made for SOCO and Sterling Energy.

Players in the industrial sector such as Morgan Crucible and Bodycote are selling at half the valuation of their US counterparts and this offers opportunities for investors to make significant profit when their value rises, as it inevitably will.

Even in the event of values falling further, commercial property companies are now looking a better return on potential investment than they have for the past two years.

With unemployment reaching its highest levels for 11 years and talk of the recession lasting well into 2009 or beyond, the FTSE could well fall lower but it looks like there is support at 3,800. There will be a number of false rallies before the indices return to any normality but if we are to believe contrarian Warren Buffett, now is the time to start investing again.

What we know from previous downturns is that when a market recovery comes it can be fast. In this at least, investors will hope that the analogy with the bear market of 1973 to 1975 rings true.

The FT30 closed at its lowest point on January 6, 1975 at just 146. Within just eight days, trading was up by 20 per cent to 176, and after 18 days the FT30 was up by 72 per cent to 252. By the end of the year, the FT30 had increased by more than 150 per cent.

The downturn has already lasted for 15 months, longer than other bear markets. The stockmarket recovery usually precedes an economic recovery. Although stocks may have further to fall before they start climbing, now might be the time for cautious, medium to long term investors to have confidence and start investing again.

Source: Money Marketing