

# MARKET FOCUS.

We think it's important you have access to in-depth market analysis of what lies behind market fluctuations and your fund's performance. Market Focus will dig deep into specific market themes so you can have the bigger picture of your investments with us.

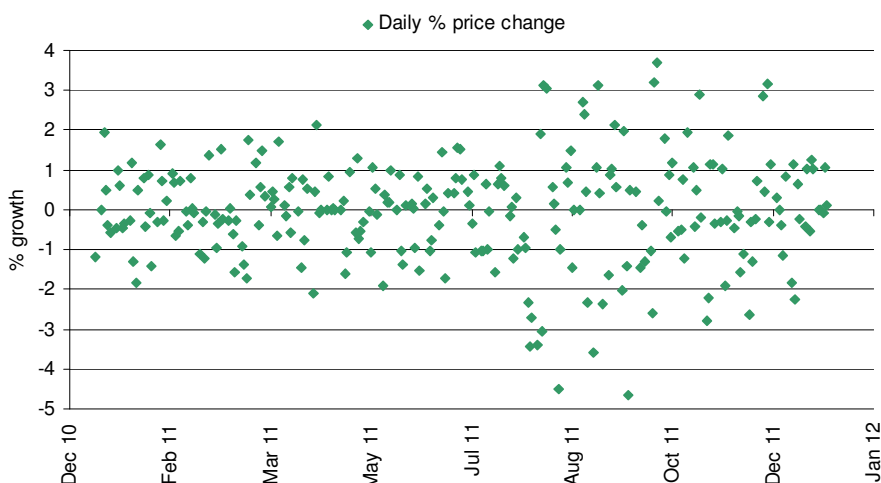
## FINDING THE BALANCE

Investing in the stock markets has always been unpredictable, but in recent years the ride has been much bumpier. With large share price swings becoming normal, we're in an era of high market volatility. This has created a difficult environment for investing. The reason for the volatility is fear and uncertainty amongst investors. Since the banking crisis, global economic issues have disorientated the financial markets. Higher risk investments such as equities have been most sensitive to the uncertainties.

In the second half of 2011, there was a resurgence of the Eurozone debt crisis and a slowing of global economic growth. This resulted in 2011 being another extremely volatile year for global stock markets, which were driven by news headlines rather than investment fundamentals.

Chart 1 illustrates the volatility of the FTSE 100 Index in 2011, with each data point representing a daily Index price change. During the course of the year the Index provided 104 days with a daily price change of more than 1% and 30 days with a price change of more than 2%, resulting in one of its most volatile years on record.

**CHART 1 – FTSE 100 DAILY PRICE DISPERSION**



Source: Lipper for Investment Management (31/12/2010 to 31/12/2011). Past performance is not a guide to future performance.

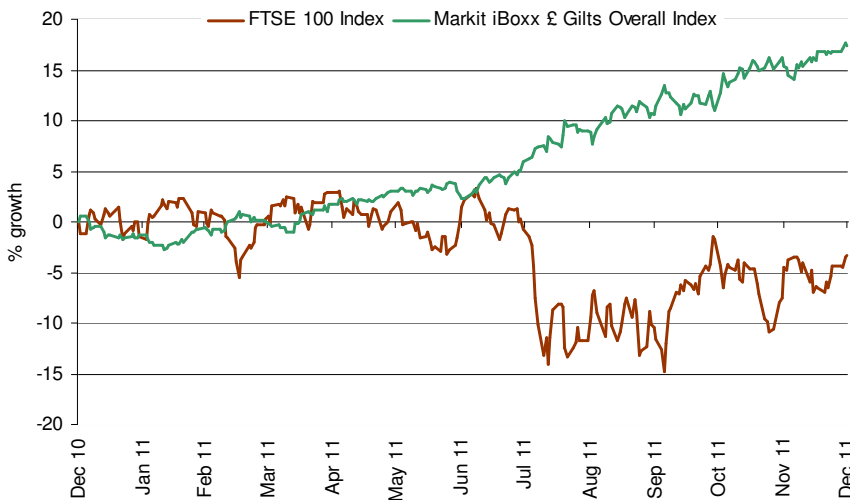
**BEWARE OF THE SAFETY TRAP**

To escape the volatility, there has been large-scale risk aversion in the markets. Investors have moved from higher risk assets into what are perceived to be low risk assets. Investment Management Association (IMA) figures show that British investors pulled a record £864 million out of equity funds in November 2011. Investors appear to have been willing to give up the potential for earning higher returns, in exchange for a lower level of risk. This is known as a ‘flight to safety’.

The flight to safety trend has, ironically, increased the risk of lower risk assets. This is because their prices have been artificially boosted by the excessive demand. In the case of low risk fixed income securities, there is a double whammy effect. An increase in the price of a bond results in a decrease in its income yield, making it less attractive to investors. UK government bonds (gilts) provide a good example of this. At their current high prices and very low yields, gilts are vulnerable to a drop in prices. When there is more optimism in the markets, investors are likely to look to higher risk assets for greater relative value and the flight to safety could reverse. Investors should, therefore, be wary of falling into a safety trap by over relying on ‘low risk’ investments to manage risk.

Chart 2 illustrates the flight to safety that occurred in 2011. Gilts significantly outperformed the FTSE 100 Index when stock market volatility increased to extreme high levels towards the second half of the year.

**CHART 2 – THE FLIGHT TO SAFETY**



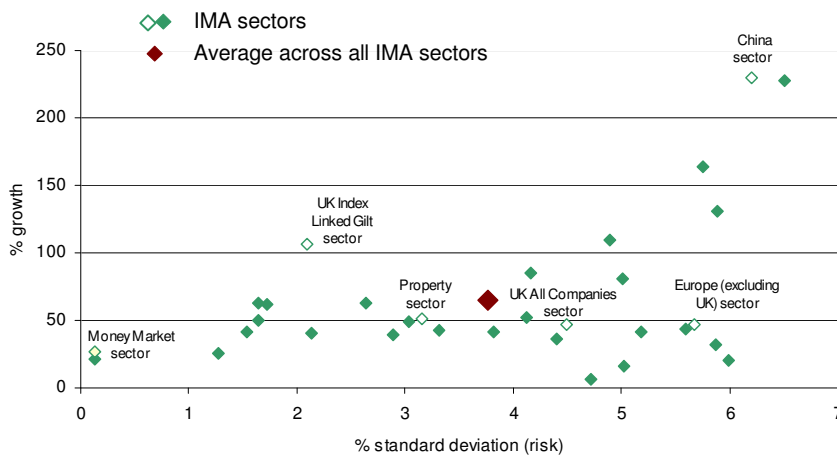
Source: Lipper for Investment Management (31/12/2010 to 31/12/2011). Past performance is not a guide to future performance.

**NAVIGATING THE STORM**

Global financial markets are highly correlated (interconnected) and are proving to be very sensitive to change. It’s very difficult to predict investment performance in this climate. In such an environment, unexpected political or economic events on the other side of the world can have a significant impact on our individual wealth. The best defence against volatile markets is, therefore, to have a diversified investment portfolio. This means spreading risk across different asset classes, sectors and securities. Taking a balanced approach will help to reduce the volatility, which in turn means focussing on value rather than short term market fluctuations.

Market volatility refers to the variability of the price of an investment over a period of time. The higher the variability of the price means the higher the risk of the investment. Standard deviation is the widely used calculation for variability and, therefore, also provides a measure of risk. In order to weather the storm, it is essential to find the right balance between risk and return. As a general rule, investors should expect a higher level of return for a higher level of risk. Chart 3 provides an overview of risk (as measured by standard deviation) versus return for all IMA fund sectors over the last 10 years. The average across all IMA sectors is included in the chart to illustrate the effect of balancing investments with different levels of risk. Finding the right balance, however, will depend on individual investor requirements.

**CHART 3 – RISK VERSUS RETURN (IMA SECTOR COMPARISON OVER 10 YEARS)**



Source: Lipper for Investment Management (31/12/2001 to 31/12/2011). Past performance is not a guide to future performance

**CONCLUSION**

Although the stock markets have been more positive so far in 2012, there is still a lot of economic uncertainty. It seems that many of the underlying issues won't be resolved in the short term and the frequent bouts of high market volatility, therefore, look set to continue. This will provide investors with ongoing challenges, but it will also provide opportunities. Depressed prices usually mean that there is value to be found. Investors with a balanced portfolio will be best positioned to withstand the volatility and take advantage of the opportunities.

**Author: Michael Petersen (IPS Investment Proposition Manager)**

*This article was written on 31 January 2012 and provides a focus on current market themes. This content should not be considered as advice, should not be relied upon as it is the view of the author at a single, historic point in time, and is for your information only. If you need advice, please contact your financial adviser, or call us on 0800 316 8540. We can only advise on Legal & General products and services. We may record and monitor calls. Lines are open Monday to Friday 9.00am to 5.30pm.*

**CONTACT US**

If you need advice, please contact your adviser, or call us on

**0800 316 8540**

We can only advise on Legal & General products and services. We may record and monitor calls. Lines are open Monday to Friday 9.00am to 5.30pm.

**www.onlineips.co.uk**

**Legal & General (Portfolio Management Services) Limited**  
Registered in England N0.2457525  
**Registered office:** One Coleman Street, London EC2R 5AA

We are authorised and regulated by the Financial Services Authority.

Q34899 01/12

Approval No. H0128521