

Monthly Report for February 2010

Fund manager's strategy report

Recession "technically" over



Regular readers of this monthly report know that over the last several years I have very rarely indulged in zealous euphoria in my evaluations of the general state of the economy. And even in light of recent, increasingly frequent positive news on the economy, not much has changed. Despite everyone's relief over the absence of a total meltdown of the financial system, an uneasy feeling remains, and with good reason. The people of Haiti understand all too well that surviving the earthquake doesn't mean coming through the catastrophe.

In contrast to an earthquake, the damage caused by a financial crisis is not often visible to the naked eye. Rather, in the short term it is often reflected in an increase in debt by affected nations and later in lower, sub-potential real economic growth. This lower growth is linked to several factors, among them the fact that many nations, in an effort to stop the downward economic spiral, open their coffers for spending initiatives (such as scrappage programs) that end up generating no income and instead lead to increased debt. Debt-financed spending only makes economic sense in the form of investments that promise returns higher than the interest associated with the debt. Otherwise, such spending does nothing but benefit individual players at everyone else's expense. However, fewer of these unfair, debt-generating redistribution practices under the guise of so-called "economic stimulus packages" or "growth acceleration legislation" are now coming into play in light of skyrocketing government debt. You might even say there is a correlation between the length of the program's name and the amount of debt it will result in.

United Kingdom

Technically speaking, the UK was the last of the twenty largest industrial nations to emerge from the recession. But why "technically"? Even though no generally accepted definition exists, a recession is understood as negative economic growth in at least two subsequent quarters. As soon as positive growth occurs in a quarter, the recession is considered "technically" over. However, it's not the first time that an attempt to apply a scientific definition to a socioeconomic phenomenon such as recession or economy recovery has failed.

In the UK example, the recession, which lasted for 6 quarters in all, led to a total decrease in GDP of 6.1%. However, just a 0.1% increase in the economy was enough to classify the recession as "technically" over. Imagine falling in a hole several feet deep, and then, after managing to climb just a few inches, being considered "technically" out of the hole.



Graphic: UK GDP progression 2004-2009

No V-shaped recovery

Last year, numerous recovery scenarios were discussed. These included, based on the various economic forecasts, V-, W-, L-, U- or √-shaped recoveries. Among these, the most optimistic scenario was the V-shaped recovery, in which a quick recovery is expected. However, an analysis of past recessions clearly contradicts this type of economic progression.

There are two types of recessions: "normal" ones and those preceded by stress in the financial sector. In the latter case, past recessions have typically been more severe, lasting several years until real economic growth once again matched potential growth. I have yet to find a reasonable argument as to why this recession is any different.

The basis for successful fund management remains a realistic evaluation of the situation. This evaluation need not always be optimistic. Rather, it is essential to position funds adequately in accordance with foreseeable risks. But isn't that what every fund manager is trying to do? Perhaps in principle. However, the main difference is that not every fund manager has the same freedom to position a fund accordingly.

A long-only fund manager, for instance, will be unable to significantly reduce market risk in a fund, even if he or she fears a market crash. ARVEST stock funds, on the other hand, enjoy tremendous freedom, which has been used successfully in the past to reduce risk. Equipped with this freedom and based on past performance as evidence of its proper use, a fund manager can safely point out risk without raising uncertainty among investors.

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