

● Finance

Stock market falls - disaster or opportunity?



John O'Connor from Omega Financial Management writes on the highs and lows of investment strategies and the reason to keep investing in a downward cycle

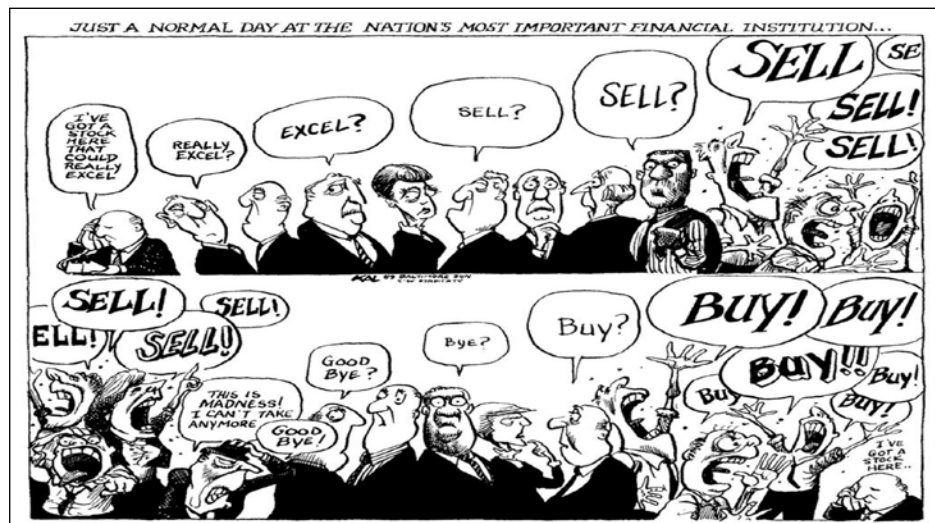
The Market Emotions Cycle

This is a very interesting depiction of the human psychology on the stock market highs and lows. Look at what most of the investors feel when they are riding up a bull run – ‘excitement’, ‘thrill’, and ‘euphoria’!

Alan Greenspan would have called it irrational exuberance. It is indeed the greed and behaviour of investors that drove the price up into a self-fulfilling prophecy – the share price is going up, let's invest.

The more money gets thrown into the market, the higher the share prices go. The masses continue to do it to a point that no more greed is able to sustain the run.

When the downturn begins, many (denial) investors will



want to ‘believe’ they have made the right investments and will continue to ‘believe’ the stock will rebound. Often, they will call themselves long

term buy and hold investors when they admit that a short term gain is not realized.

As the downturn worsens, ‘fear’, ‘desperation’ and even

‘panic’, create another self-fulfilling prophecy – the share price is falling, we need to sell. The more they sell, the more the prices will drop.

This cycle describes very well how we tend to react to our fortunes and often misfortunes during the investment cycle of the stock markets. In many ways it demonstrates great ironies in terms of our reactions to both the performance of our investments and also of the different trends of the markets.

How does it effect our own Investment Strategy

Speaking to many people at present I can sense their dependency in relation to their pension funds. I often hear people talk of how they have stopped paying into their pensions because their values have fallen so much in the last 18 months. It is very hard to argue with this until you see how the market can go against such a strategy.

The Market emotions cycle shows how we can get caught out by this. It is frustrating enough to know that we have suffered falls in our funds without having salt rubbed into our wounds by ceasing to contribute and then seeing the markets recover and not getting the benefit of it.

We must remember that as prices fall we buy stock cheaper and this should encourage us to do more rather than less.

Deflation

In economics, deflation is a sustained decrease in the general

price level of goods and services. Deflation occurs when the annual inflation rate falls below zero percent, resulting in an increase in the real value of money – a negative inflation rate.

This should not be confused with disinflation, a slow-down in the inflation rate (i.e. when the inflation decreases, but still remains positive).

We may feel that falling prices is a good thing and that we will get better value for our money during deflationary periods. However the opposite is more often true.

Deflation tends to be bad for economies because we hold off buying this week as we feel we will get it cheaper next week.

This is particularly true of our major asset purchases such as houses and cars. Rising prices at a low level is usually considered the ideal price movement because it keeps us buying goods for fear we will be able to afford less of them in the future.

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