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"Where are we now?"

I have heard October 2008 described as a "once in a generation event", a "once in a 100 year event" and even a "once in a thousand year event". Which of these it is, I will leave to the statisticians. My view is that the only thing that it proves is that intellectual arguments about 'valuation' are irrelevant to a crowd in panic mode. In October, the crowd was in full flight and the financial system creaked under the strain. The pundits have had a field day (who was Robert Peston before Northern Rock?) and have declared "history in the making" and that we are in uncharted territory.

The thought that occurs to me is this: that the financial system was threatened, at all, is due to the same forces that have always driven our economies to excess: greed, gearing and over-confidence. That these have been expressed on a global scale through derivatives is the new part, the rest is the old boom-bust cycle that Gordon Brown (hubristically) said he had abolished. It's the one I grew up with as a schoolboy in the '70s. And, guess what? The Big 3 US car giants are threatening to go bankrupt, again! In the words of Yogi Berra: "it's like déjà vu all over again."

It is true, however, that strange and unbelievable things are happening, almost daily. The outcome of the US election would be a good example. Another is the return of (Lord) Peter Mandleson to domestic politics. Even more fantastic, the reincarnation of Gordon Brown, not as the architect of our misfortune, but as saviour of the banks! However, when the history books are written only one figure will most often be cited as standing tall, John Wayne-like against the tide of despair: US Treasury Secretary Hank Paulson.

So, where are we now? The world's major economies, if not officially in recession are heading in that direction. It's going to be a tough Christmas: unemployment will rise, house prices will fall and some companies will disappear. This much we know, because we have seen it before. The politicians' response is Keynesian: borrow and dig holes in the ground (presumably the 2012 Olympic hole being the best example, as private capital flees the scene). It is a dangerous game, but probably necessary. However, as one economist put it on Newsnight - this is what you do after all monetary stimuli have failed.

What of the equity market? It is hard to make firm statements about valuation, given that the short-run outlook for earnings and dividends is so uncertain. However, if prepared to look further out, the shares of companies that will prosper in the coming years are probably very cheap. Equally, as credit markets have dried up, corporate bonds also look very cheap. What will be the catalyst for a recovery in valuations? The answer: greater confidence in the future. The building blocks for this financial recovery are being laid: interest rate cuts right across the globe; falling inflation; falling food and metals prices; falling oil prices; credible bank rescue packages and a reinvigorated IMF (able to rescue emerging markets). As to the potential shape of that recovery, please do read Richard Champion's PIMview.

What have we been doing? The most recent cut in interest rates makes cash an unappealing asset so we have been adding corporate bond funds to portfolios. Within the equity market we want to position ourselves for a recovery and have been adding suitable funds - for example Schroder UK Alpha, Psigma Income, Findlay Park US Smaller Companies and, controversially, Jupiter Financial Opportunities. The latter may sound counter-intuitive, but the thought process is simple and it is a fund we have used for Growth clients for some time. Philip Gibbs has managed this fund with great skill, raising cash late in 2007, and thereby cushioning investors from the fall in markets. On the other hand, when the dust settles, the surviving financial institutions will face a very different competitive landscape. The healthy will prosper, and yet those companies have very depressed share prices - for now. How have our clients' portfolios been performing? For the month of October our clients' portfolios broadly outperformed their benchmarks. That is the good news. The bad news is that, of course, those benchmarks all saw negative returns.

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