

Sacramento Bee's Ask the Experts

Help with personal finance

[Answered at 5:07 AM on October 10, 2008, by Jeffrey Lambert in the Sacbee Ask the Experts](#)

Don't Give in to Fears

Q: I fund my retirement by investing with each paycheck. I have 10 years before I can think about retirement. My retirement statements, like everyone else, look awful. What should I do? Hang in there or stop funding the investment and put the money elsewhere? If elsewhere, where?

Submitted by HSBALL from East Lansing, MI

Thank you for asking a question that in some form is on everyone's mind.

These last few weeks have been exceptionally volatile and gut wrenching for us all. In our office we have a crystal ball. The view into it is always clear. As we view into it, we see the desk top on which it is sitting. Although we cannot forecast the future, we can learn from the past and from the current market and economic data.

US and World Fiscal and Monetary Policy

The markets are bouncing around dramatically in response to coordinated global central bank interest rate cuts. The US Fed on Wednesday lowered the discount rate by one half of one percent and central banks around the world also lowered rates. The coordinated rate cut is further evidence of a global credit crisis. Charles J. Blankley of Gemmer Asset Management summarized other major policy actions:

- US Federal Reserve Board action to increase liquidity by creating a new auction facility by introducing to support the commercial paper market.
- The passage of the Troubled Asset Recovery Plan (TARP) by congress last week. This program is being implemented with unprecedented speed.
- The British Treasury partly nationalized eight major banks through what is called a recapitalization plan.

- Ireland and Germany have moved to guarantee their domestic retail deposits.

The sum of policy actions shows both the gravity of today's situation and the efforts of global authorities to take whatever steps are necessary to support the financial markets and the economy.

The Cycle of Greed and Fear

Although many details of the events of the last few weeks are historically unprecedented, a long view of history reveals that the basics of the current crisis is same as what has happened before. The run up in home prices, indiscriminate lending, leveraging of mortgage backed securities and the subsequent collapse and the indiscriminate selling of equities and certain fixed income categories is classic bubble and collapse. On both sides of the cycle excesses abound.

In an effort to clear our heads and get away from the current noise we see the age old pattern of greed and fear. The markets are currently gripped in fear. This is to be expected as a result of the excesses of the recent past. We hear worries that include everything from fear of a global recession/depression to insolvency of the banking system and general fear of the unknown.

Almost everyone is being swept up in the herd mentality and are running off a cliff. This is the common reaction. The bad news of today is being seen as continuing for the foreseeable future. The herd thought home prices would never go down. The herd now believes that the economy and markets are going to stay the way they have been for the last few days. As always, the media is playing a part in fanning these fears.

Economic and market cycles are a normal part of the system as it works its ever effective process of seeking and finding equilibrium. Yes, we are facing a much weaker US and world wide economy over the next few quarters than we expected just two months ago. Yet, the fears of a global depression are unwarranted. Policy making tools of today are so much more powerful than ever before. What caused the great depression of the 1930 is no longer possible. Although policy makers are not acting perfectly and with the speed that we in today's "we want it now" age expect, the tools being deployed will work. The recent steps to recapitalize the banking system, provide liquidity, and reduce interest rates are modern tools up to the task.

One of the factors complicating matters is the liquidation selling taking place. Individual mutual fund and hedge fund liquidations are soaring and this selling is putting unusual downward pressure on an already unusually illiquid market.

Ultimately the forced selling will end, and the "Armageddon" view of the world will subside. Those who kept their heads will not have been a part of the problem and will be in the position of capitalize on the run up that always has occurred after the sell off. This cycle of fear will come to end as it always does.

When Will It End?

Expect to see further policy actions that may include more global central bank rate cuts, as well as new or expanded programs to provide liquidity and capital to the global banking system. While something of a simplistic characterization, we are in essence throwing money at today's problems. From Milton Friedman we know that inflation is always and everywhere a monetary phenomenon. The infusion of new money into the banking system and the capital markets will ultimately work, yet will create inflationary pressure. We will see higher prices in the financial markets and also in the price of good and services in the long run. When the financial markets do recover, those who are currently seeking a safe haven in cash or Treasury securities are unlikely to be well compensated in the coming years.

Over the decades investors have been rewarded by buying fear and selling greed. Today is no different. We are experiencing the buying opportunity of a decade. The cycle of fear and greed is playing out once more.

HS, the best thing you can do it to keep investing each month.