

It Was the Best of Times, It Was the Worst of Times

The economy is bubbling right along, but investors are puzzled about just where the bucks can be made

By ANNA BERNASEK

BYRON WIEN CAN MOVE MARKETS. AS chief strategist at Morgan Stanley, one of Wall Street's biggest investment banks, his decisions affect interest rates and stock-market prices from New York to Sydney. Last week, along with hundreds of other heavyweight investors, Wien cut from the market and ran for the safety of cash.

It seems that everyone, from international investors with billion-dollar portfolios to retirees trying to shelter a few thousand dollars, is having the same problem—finding a safe, profitable place to invest. The stock market is as uncertain as Melbourne's weather. Government bonds are safe, but people are scared of tying up their money. Real estate prices aren't going anywhere in a hurry and cash deposits get eaten away by tax and inflation. "I try to console myself by thinking if it was easy everyone would do it and we'd never be able to make any money out of it," says David Andrews, chief economist for Sydney-based investment managers Equitlink. The frustrating thing is that most people think they know the main cause of uncertainty—fear of higher inflation and interest rates—but no one seems to have an easy cure.

Last week, the flight to safety left the Dow Jones Index down 140 points, investors shaken and markets vulnerable. In Australia, the latest sell-off has hit as investors pack up for Christmas after the worst year on finan-

cial markets since the 1987 crash. The Australian market has already slumped 20% this year and likely future rises in interest rates will drag down companies' profits and their appeal to investors. "We are now entering the downward phase of the market," says Rodney Adler, chief executive of FAI Insurances. "We will not see the highs for quite some time." Long-term government bond rates are already high, almost 11%, but they could be pushed up more by inflation and international competition for capital. Higher interest rates have already dampened the residential housing market. There are bright spots, but overall the real estate market is going sideways. Late last month, the National Australia Bank clamped down on lending for inner-city residential units.

The cause of all the market mischief has been the shift from grudging recovery to boom. In February, the U.S. Federal Reserve was confident enough to end a five-year period of falling interest rates and Australia soon followed. Since August, the Reserve Bank has raised the official overnight cash rate by 1.75% and it now stands at 6.5%. "What has been unusual this year has been the extent of the rise in long-term interest rates and the flow-on effect onto the sharemarket," says Charles Macek, managing director of County Natwest Asset Management. Some say rising long-term rates show markets are worried that the boom might collapse back to bust. Others argue that trend-makers in the financial markets

are bound to the notion that growth automatically equals inflation. "People in the markets are all prisoners of history," says Macek. "Few people working in the market today go back to the last time we had a low-inflation environment in the '60s."

It's hard to know when financial markets will reflect the more upbeat view of the larger economy. In the meantime, many big and small investors have protected themselves against further turmoil. Even the usually aggressive Adler is cautious. "We've been buying bonds, but we're keeping to the short end because it's safer and less volatile. We don't believe that Keating will reduce the deficit fast enough, so rates will have to rise more. So we've taken a defensive position in the stock market. We haven't been investing in other countries because we're just not sure what's going on there." For investors stuck with losses this year, there seems only one solution: Wait it out. Says Leigh Hall, deputy managing director of AMP Investments: "Now is not the time to be bailing out of anything. If you lost a lot of money this year on the market, you simply have to accept that the returns should be better from here on."

SOME MAJOR INVESTORS SEE THE chance of a golden six to eight years of growth. "If the presumption is right that inflation will rise only slowly, then we're likely to see long-term rates stabilize and even rally despite short-term rates going up. As that happens and economic growth continues, the share market should begin to rise again," says Macek. Others are already looking for signs of another recession. "The big issue will be to look at the real economy and see whether the activities of the monetary authorities will cause a downturn in the economy. There are already some people mentioning the R word in the United States," says Hall.

For all the analysis, the markets still stubbornly refuse to accept the rule of computers and experts. The past is already the stuff of detailed financial reports; the future is still a throw of the dice. ■

