RISKY BUSINESS DOWNTURN ILLUSTRATES GLOBAL VULNERABILITY

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In Chinese astrology, this is the Year of the Pig. But if the recent downturn in financial markets continues, it may make 2007 seem more like The Year of the Dog.

China's Shanghai stock index plunge, which caused the Dow Jones Industrial Average's largest weekly percentage loss in four years, caught the world off guard.

But the Shanghai Surprise will likely turn out to be a mere rut on a long road over the hills and through the valleys of global finance. The market jolt exposes the increasingly small financial world and reminds investors that they can't diversify themselves away from risk.

"It's a little disappointing," said Gary Mellor, a computer software developer in Woodland Hills who has mutual funds through Washington Mutual and T. Rowe Price, but none with holdings in Asia.

"Fortunately, I have a few more years until retirement."

Jamie Chien, an ad salesman for the San Fernando Valley Business Journal, said that when he heard the main Shanghai Stock Exchange index had declined almost 9 percent, he got nervous.

"I know part of my fund is in Chinese stocks," he said. "I haven't had a chance to look yet, but I'm pretty sure I took a hit."

Any excuse will do

Most investors are taking the correction in stride. In deconstructing exactly why events in Shanghai were able to shake global markets, economists and money

managers say that the fragile condition of the U.S. economy set it up for a correction.

"What happens with a turning point in the economy is that markets can be easily spooked, especially when they have been overvalued," said Thomas Higgins, chief economist at Payden & Rygel, an investment management firm downtown with more than $50 billion under management.

He said that absent larger economic pressures such as the degenerating mortgage market and slowing economic growth, U.S. stocks probably would have been better insulated against the Chinese sell-off.

"If it weren't for the fact that the U.S. economy is where it's at, I don't think it would have led to what it did."

Higgins said that overall, equities will still post positive annual returns, but at single digits as opposed to double digits investors have gotten used to.

"These markets are much more integrated than they were 10 or 20 years ago," said Robert Krol, a professor of economics at California State University, Northridge.

"If a country is being well-managed, it can weather these market gyrations pretty well. I don't know if (the correction) is a wake- up call that there may be chinks in the armor (of Asian economies).

"Maybe people need to take a harder look," Krol said.

Diversify, but beware

If all markets have the power to influence stock prices and values worldwide, what happens to the classic strategy of not putting all your eggs in the same basket?

"I still believe diversification is a way to go," said Kenneth Caleb, a financial adviser at Diversified Securities in Long Beach, who sees a buying opportunity in the wake of the latest sell-off.

Even when someone only owns stocks, diversification in overseas markets is still a good hedge against losses, Caleb said.

Of course, putting money into different kinds of assets, like bonds or real estate in addition to stocks, is also a good way to diversify.

In fact, Robert Goldsmith, a financial planner and trainer in Simi Valley, thinks a growing awareness that globalization makes markets worldwide more vulnerable to events anywhere will prompt people to pull money out of the stock market and find alternative investments, like real estate or gold.

Since "anybody with a mutual fund is exposed" to some emerging market risks, he said the question consumers need to ask themselves when the market suffers a drop is what kind of money they have at play in the markets. He advocates clearly differentiating between savings earmarked for retirement and extra money that is to be used to gamble on high- risk/high-return investment.

Separating retirement money from "play money" is probably not something most people are doing, especially most workers who don't even know what mutual funds they have or how much they have made or lost.

"I'd say 50 percent of people have no idea what they put in their 401(k), and they don't care," said Michael Sakai, who sells mutual funds for New York Life Insurance Co. in Woodland Hills.

As financial planners constantly advise, however, investors should care, because it's their money.

Figuring risk

The general rule of thumb to determine how much risk to take is to subtract your age from 100, said Goldsmith.

The amount left over would be the maximum ratio you could consider as play money.

So a 60-year-old wouldn't want to risk any more than 40 percent of assets.

Investors who have met their retirement goals could view the Nikkei index -- Japan's benchmark Asian stock index 7/8 as a buy after what happened last week, for example.

Joe Quinlan, chief market strategist for Bank of America, told Dow Jones TV that investors should take profits from emerging markets on fire for the last few years and put them into large-cap U.S. stocks, which have been lagging the broader market.

Just setting investment dollars aside somewhere and forgetting about them, the

experts say, is a bad idea.

As for the market going forward, most market watchers say the recent correction could linger uncomfortably long.

"If we manage to make it through the next couple weeks without another day like that, I think people will begin to take on more risk," Higgins said. "But I would think that for the next couple weeks, the market's going to be on edge."

Joseph Rubinstein, an asset manager in West Covina, said his outlook is generally positive.

"This has been a tough week, but investors have been behaving rationally. I can't predict the short-term noise in the market," he said, "but I believe the economy is in relatively good shape."

barbara.correa(at)dailynews.com

(818) 713-3662

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