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## Jurrien Timmer: Panic is not a strategy

By Jurrien Timmer, Director of Global Macro for Fidelity Management & Research Company (FMRCo) and portfolio co-manager of Fidelity Tactical Strategies Fund — 08/05/11

### Don't risk selling at a low as many ended up doing in early 2009. Have a plan.



Thursday, August 4 will be a day for the history books. The Dow Jones Industrial Average plunged over 500 points in a single day. Oil fell five bucks, the long bond rallied four points, and even gold—that safe haven—fell sharply. The major averages are now firmly in correction mode with declines of more than 10%, and are down some 8% in just the past 10 days. Painful, certainly, but it also could mean an opportunity for those with a strong stomach. Despite all the bad news, stock valuations are reasonable, corporate earnings have been strong, and today's jobs number in the U.S. proved better than expected.

What is going on?

To sum it up, I would say, for the moment, investors appear to have lost confidence. Investors are “checking out.” There is a growing sense now that the U.S. economy is not strong enough to stand on its own two feet, and that unlike 2009, it will get neither the fiscal response from Congress, nor the monetary response from the Fed to bring it back to life. The U.S. is out of ammo—at least for the moment. At the same time, Europe's debt markets are struggling and the ECB (European Central Bank) is not helping matters with its tight policy. On top of that, there are strong movements afoot in the currency markets. On Wednesday the Swiss central bank lowered rates in an attempt to bring the Swiss Franc down, and on Thursday Japan's central bank intervened in the currency markets to try to drive the Yen back down. As a result, the U.S. dollar has rallied sharply and that has further undermined the stock market.

August 4 may have made the headlines, but I think things really started to come unglued during the U.S. debt-ceiling debacle last week and over the weekend. Some expected that when the U.S. debt ceiling was finally raised, there would be a relief rally in stocks. But it didn't come.

Another reason may be that the U.S. economy seems to be weakening, perhaps significantly. Not only did second quarter GDP come in light, but the first quarter was revised to a barely positive reading. And then the ISM (Institute for Supply Management) report, a manufacturing survey, missed expectations by coming in at only 50—a reading under 50 means the goods-producing economy is contracting.

At the same time, things in Europe have gone from bad to worse. Not even a week after the summit that was put together to deal with the sovereign debt crisis in Europe's periphery, the bond markets of Spain and Italy started to unravel. The markets there are looking to the ECB to come to the rescue, and indeed ECB President Jean-Claude Trichet did announce yesterday that the ECB would extend its liquidity program and that it could buy more bonds. But he emphasized that inflation is still a concern, and suggested that the ECB's response could be lackluster at best. All in all, the markets were left wanting more.

Which brings me to the Fed. The economy is now as weak as it was a year ago (or weaker) when the Fed did QE2. What are next steps for the Fed? There seems to be a sense among investors that either QE3 is not coming at all, or if it is, that it will be too late or not potent enough. The Fed is watching the sea of red ink on its monitors the same way that we all are, but unlike a year ago when it did QE2, inflation is higher and the political support for more stimulus is lower. And that makes it harder for the Fed to respond in the same way that it did the last time. If it does respond—and I think it's only a matter of when—the risk is that it will try to ease “verbally” by committing to an even longer period of cheap money than before. We'll see if that's enough to appease nervous investors.

The bottom line is that the economic recovery has been disappointing, and when you add fiscal tightening to that, it is important to match it with monetary accommodation. In Europe we have had fiscal tightening AND monetary tightening. In my view, that's an untenable combination. And now the risk is that inflation in the U.S. may be too high to allow the Fed to compensate for fiscal tightening and a slowing economy. To me, the ideal scenario would be for the economy to pull itself out of its mid-cycle slump all by itself, and in that sense this morning's decent employment report is quite encouraging.

I think the ball is now in the Fed's court. The FOMC is next week and the annual Jackson Hole conference (which a year ago was the launch pad for QE2) is later this month. The market is craving for some sort of response from the Fed. Will Bernanke oblige? I think he will, but will it be enough?

### What's an investor to do?

The S&P 500 is now at 1200 even, down 171 points from its recovery high earlier this year. If you have confidence that the economic slowdown is only a mid-cycle soft patch and that earnings will continue to come in as they have, then stocks look pretty compelling here. After all, where are we supposed to put our money? In Treasuries yielding 2.5%? In cash yielding zero? It's tough being an investor these days.

The important thing to remember about days like Thursday is that you should maintain perspective and have a sound asset allocation plan. Panic is not a strategy. Remember that the S&P 500 had still risen 77% off its bottom in March 2009 through Thursday. If you have a good plan, one that makes sense for your situation over the long term, then it is important to not get sucked in by the chaos and emotion. Many investors who pulled out of the market in early 2009, found themselves selling at the low.

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