



## Interest Rate Cycles and the Stock Market

Interest rates move in cycles, and now that the RBA has reduced Australian benchmark rates for the first time since 2001, by 0.25% to 7%, further cuts are likely according to the pricing we see in bond markets.

Lower interest rates are good for consumers and businesses, but what about the share market?

Since 1989 there have been three previous interest rate cutting cycles in Australia. On each occasion the All Ordinaries index has generated a positive return from the first through to the final cut of each cycle. The best returns have occurred when the rate cutting cycle commenced while the market was significantly below its highs. Similar to 1989-93, the All Ord's was 28% below its peak when the latest interest rate 'easing' cycle began in early September.

## All Ord's Performance During RBA Cutting Cycles

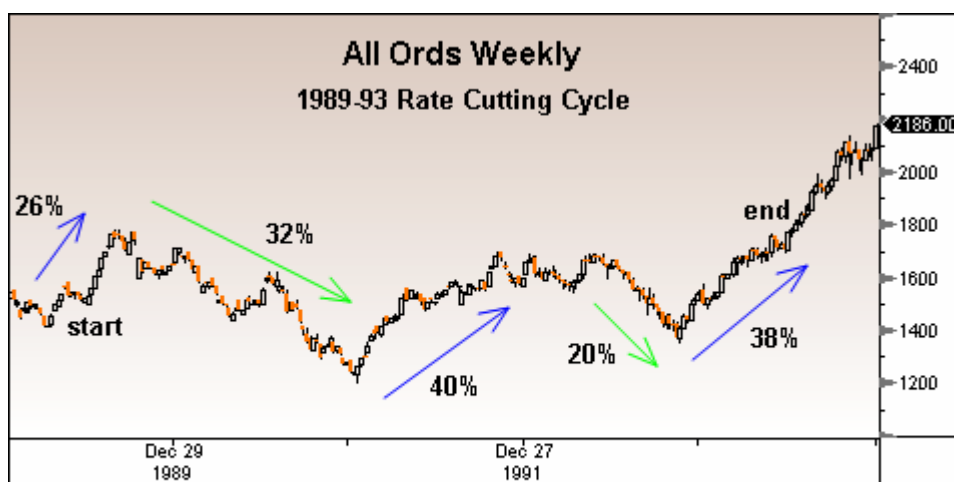
Easing Period	% Below All Time High when Cycle Commenced	% Return through to final cut
Jun 89 - Jul 93	>30	24
Jul 96 - Dec 98	9	32
Feb 01 - Dec 01	1	2

By the end of each past easing cycle the All Ord's has finished in positive territory, with the greatest returns generated when the interest rate cutting began while the market was significantly below all time highs.

Source: wise-owl.com, RBA, Bloomberg.

History suggests that significant gains could be in store over the coming years, however, investors should not ignore the importance of timing, as buying at the wrong time can dramatically hinder your outcome.

Case Study: 1989-93



Although the All Ord's ended 24% higher during the 1989-93 rate cutting cycle, it was a rough ride along the way, and so market timing was very important.

Source: wise-owl.com, Bloomberg.

Although our market finished the 89-93 easing cycle around 24% higher than where it began, it was not all smooth sailing. Numerous times the market plunged 20-30% only to rally back even harder. While such volatility is ok if you



buy on the dips, the reality is that such practices are often preached but not practiced. The natural instinct for most investors is to buy after their confidence in the market has returned, which is usually following a recovery rally.

Unfortunately, such periods often coincide with the onset of further near-term weakness. And even if you have the nerves to withstand the ensuing retracement, the ultimate payoff can be very marginal. For example, during 1989-93, had you waited for the market to respond to the initial rate cut and bought just three months later in September '89, your result come the bottom of the rate cycle in July 1993 would have been markedly different, with the All Ord's returning just 4% over the period.

So while time *in* the market is important, so is market timing. These volatile periods can produce significant rallies in the range of 30-40%, as the chart above shows. And the only thing more painful than being part of a market downturn is not taking advantage of these often violent recoveries.

Navigating through such volatility requires a 'bird's eye view' of the market, and recognising the opportunities available, we have selectively been advising our members to start accumulating some of the quality bargain stocks on offer.