Investing During Uncertainty

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Every day it seems like the world is getting smaller. If you watch any financial television station or read the newspaper, you are most likely aware of how events in one country seem to have an ever-increasing affect on other countries around the world. We are more interconnected now than at any other time in history. It goes without mention that globalization definitely has its positives, but when threats of financial crisis, war, global recession, trade imbalances, etc, do occur it often leads to talk of moving money to safer investments and increasing government deficits. This rising uncertainty can confuse even the well-informed investor.

Uncertainty

Any time you put money at risk for the chance of profit there is an inherent level of uncertainty. When new threats such as war or recession arise, the level of uncertainty increases significantly as companies can no longer accurately predict their future earnings. As a result, institutional investors will reduce their holdings in stocks considered unsafe and move the funds to other sources like precious metals, government bonds and money-market instruments. This sell-off, which occurs as large portfolios reposition themselves, can cause the stock market to depreciate.

Effects of Uncertainty

Uncertainty is the inability to forecast future events; people can't predict the extent of a possible recession, when it's going to start/end, how much it will cost, or what companies will be able to make it through unscathed. Most companies normally predict sales and production trends for the investing public to follow assuming normal market conditions, but increasing levels of uncertainty can make these numbers significantly inaccurate. (For more, see *Recession: What Does It Mean To Investors*.)

Uncertainty itself can affect the economy on both the micro and macro level; a description of uncertainty on a micro level focuses on the effect on individual companies within an economy faced with the threat of war or recession, whereas the view of uncertainty on a macro level looks at the economy as a whole (To learn more, see *Economics Basics*.):

- From a company-specific point of view, uncertainty provides a major concern for those that produce consumer goods every day. For example, consumption may fall on the threat of a recession as individuals refrain from purchasing new cars, computers and other non-essentials. This uncertainty may force the companies in certain sectors to layoff some of its employees so that it can combat the impacts of lower sales. The level of uncertainty that surrounds a company's sales also extends into the stock market. Consequently, stock prices of companies that produce non-essential goods sometimes experience a selloff when levels of uncertainty rise. (For more, see *The Impact Of Recession On Businesses*.)

- On a macro level, uncertainty is magnified if the countries at war are major suppliers or consumers of goods. A good example is a country that supplies a large portion of the world's oil. Should this country go to war, uncertainty regarding the level of the world's oil reserves would grow. Because the demand for oil would be high and the supply uncertain, a country unable to produce enough oil within its own borders would be required to ensure that enough oil was stored to cover operations. As a result, the price of oil would increase.

- Another macro-level event that affects companies and investors is the flight of capital and devaluation of exchange rates. When a country faces the threat of war or recession, its economy is considered uncertain. Investors attempt to move their currency away from unstable sources to stable ones; the currency of a country under a threat of war is sold and the currencies from countries without the threat are bought. The average investor probably would not do this; however, the large institutional investors and currency futures traders would. These actions translate into a devaluation of exchange rates.

What's an Investor to Do?
When situations of heightened uncertainty arise, the best defense is to be as well informed as possible. Keep updated by reading the newspaper and researching individual companies. Analyze which sectors have more to gain and lose with a war and decide on a long-term plan. Times of heightened uncertainty can lead to great opportunities for investors who position themselves to take advantage of it. Some investors might decide to be offensive and search for companies that provide goods or services that will lead to great returns when things turn around. It is difficult to commit capital during uncertain times, but it can often reap huge rewards in the longer run. Those who want to mitigate uncertainty and risk might be content leaving their money where it is or perhaps moving it to safer securities.

Regardless of which strategy you decide to take (if any), you can't go wrong over the long term by keeping yourself well informed and getting into a position so that you can take advantage of prices when the things reverse.

For further reading, see *Intro To Fundamental Analysis*.

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