



Engage Your Noise Filter

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If you have ever found yourself reading a newspaper, checking emails or concentrating on a task to the extent that you have not even registered someone standing close-by (read co-worker, spouse or child) talking to you – then you will be familiar with the principles of background noise filters.

There are a number of rules of engagement when investing and possibly the most important one is to focus on your long-term investment strategy and do your best to filter out the barrage of background noise that will unsettle your nerves if you give it the opportunity – especially in times of increased market volatility such as we are experiencing at the moment.

Noise emanates from a number of sources – from newspapers, television, fund managers to friends at a barbeque. There are a number of possibilities that explain why companies publish information about stock markets to the public free of charge.

It is possible that the media has your best interests at heart when publishing a wide variety of economic and market news via online newspapers. We could be forgiven for believing that the fantastic headlines are an effort to get us to click on the article and see another wall of banner advertisements that boost the revenue of the media moguls rather than to present us with a true representation of the state of the global economy.

It is also possible that financial institutions have their in-house economists regularly publish accurate forecasts of the global economy so that you can make investment decisions that are guaranteed to make you money. We may be forgiven for not being able to remember the last time an economist actually got three forecasts or predictions in a row correct. We may recall a certain economist walking from Canberra to the top of Mount Kosciuszko as a result of a losing wager on housing prices recently.

Let's face it; headlines sell newspapers and forecasting should be left to the weathermen (that is not to say that weathermen are particularly good at forecasting either).

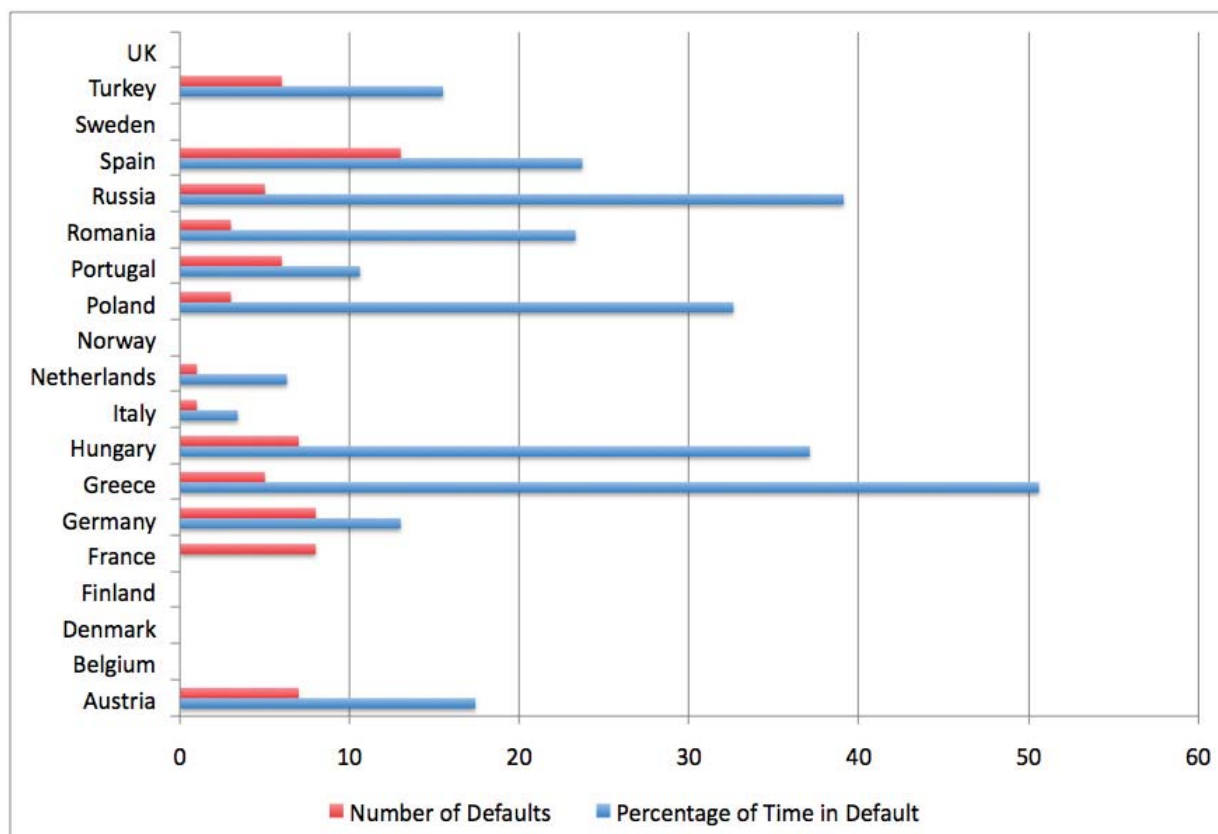
One might ask how we can make informed investment decisions. Well... it is not a new idea that as investors our decisions are often driven by two emotions - fear and greed. A downward trending market in the short-term will usually trigger fear (urging us to take the flight to cash) whilst an upward trending sharemarket in the short-term will usually trigger greed (urging us to invest in riskier assets). These emotions are real; as money is important to us and that tends to magnify these feelings.

A well constructed portfolio will be positioned to take advantage of the rising market while still providing some shock-proofing on the downside, but it is important to understand that risk is inherent in all investments. When we talk about investment risk in a long-term portfolio of five years or more we are referring to the degree that short-term volatility will impact our portfolio valuation. In taking a position of risk in a portfolio we are expecting a given level of investment return for taking on an agreed level of investment risk. In order to stick to our strategy, it is important to filter out much of the background noise and stay focused on the long-term potential of our portfolios. Equally, it is important to keep up to date with global economic news and events, but rather than attempt to shuffle in and out of cash in the short-term to outwit the sharemarkets and magnify profits (a most unlikely chance of success) we should be looking for opportunities to invest.

continued overleaf

The Euro Zone

Possibly the noisiest topic in the fear camp at the moment is the Euro Zone. The PIIGS (Portugal, Italy, Ireland, Greece and Spain) and now Hungary are all in danger of defaulting on part of their sovereign debt as their current options for restructuring their debts are becoming limited. The chart below shows how many times these countries have defaulted since the year 1800 or their independence and the percentage of time in either default or restructuring. My point is that although this chart represents a long time horizon, the concept of debt default and sovereign risk is nothing new.



*Source: Reinhart and Rogoff 2008

In the last decade or so we have seen defaults from Argentina (2002), Russia (1998) and Ecuador (2008), while countries including Pakistan, Ukraine and Uruguay have restructured their debt in the face of default. Although these events were quite severe for those countries at the time, there remained opportunities to invest in other countries. This holds true today. We are seeing a continued improvement through Australia, Asia, India and the US economies as well as some of the Latin emerging markets. The key to a successful investment strategy is whether investors will be able to weather the increased volatility that is typical throughout a post crisis recovery. My thoughts would be that this is only going to be achievable for us as individual investors if we filter out the background noise, focus on the long-term strategy that we have implemented with the assistance of a financial adviser and review our strategy at least annually.

Financial advice

For any further information or to discuss your financial situation, please don't hesitate to contact me on **0413 244 733** or email simon.whiteley@eqtsuper.com. I look forward to hearing from you.

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