



## Do not forget why we are here.

**Simon Whiteley, Equity Trustees Superannuation Limited**

There have indeed been some dark days for investors over the past few years. I know this because not only do I provide investment strategy advice to many of the readers of these articles, but I also put my money where my mouth is and I invest right alongside you. It has been an emotional journey for us all, and together we are only at its beginning, whether it be in the wealth creation or the retirement phase of your life. With the GFC a recent memory, it is easy to lose sight of the bigger picture; what we are trying to achieve, and why we put ourselves through all of the stress that a volatile share market inflicts upon us. This month, I hope to remind you why we are here and what it is all for.

Cash is not King. The long term cash rate is around 5%. Now ignoring tax and investment fees, but allowing for inflation at say 3%, we are left with a 2% return pa. So for every \$100,000 invested we can expect, at best, a return of \$2,000 in real terms. So to achieve an income in retirement of \$50,000 pa we would need to invest \$2,500,000.

In investing, we often refer to the cash rate as the risk-free rate, although it is not actually risk-free. It is referred to as risk-free because there is very little chance of investment loss by investing in cash, particularly when investing in a top-tier bank deposit, possibly through the big four banks. It is not risk-free because, like any business, banks are run by people and unfortunately not all people are equal. Investing in cash is basically an unsecured loan – yes, you may get priority over shareholders in the event the bank is wound up - but you may also get nothing at all. It is a minimal risk but not impossible, particularly if your deposit is held in a European bank right now.

I recently had a client ask me “I know they say it is all about time in the market etc, but what do you really think about the markets? Should I be in or out?” The client was referring to the insight that investing is not about timing the market but time actually invested in it. Perhaps the finance industry is guilty of over-use of this insight, but even so it holds true today. The fact is that no single investor has been able to successfully time the market over an extended period of time. On the other hand however, investors who have remained disciplined and kept a long-term investment focus have reaped some very attractive investment returns. The table below which is sourced from vanEyk Research, shows the historical returns for each risk profile for a diversified portfolio for the period from 31 January 1971 to 30 September 2011.

Portfolios (All Data Gross of CPI)	Conservative	Moderately Conservative	Balanced	Growth	High Growth
Average Historical Return	10.79%	11.62%	12.39%	13.03%	13.58%
Average Real Return	4.79%	5.62%	6.40%	7.03%	7.58%
Worst return over any 12 months	-8.65%	-18.43%	-27.05%	-33.97%	-39.64%
Best return over any 12 months	28.03%	34.89%	43.96%	52.30%	60.68%
Likelihood of Negative Return (1 yr in...)	18.34	7.95	5.88	5.18	4.67
Probability of negative return	5.45%	12.58%	16.98%	19.29%	21.38%

I would challenge almost any investor to look at the average historical return and show dissatisfaction with the investment outcomes of each of these investment strategies. If we extend our example of a cash investor requiring an income of \$50,000 per year and apply this to the Balanced investor, then based on an investment return of 12.39% pa less 3% pa to allow for inflation, the capital sum required would be a more realistic \$532,482.

So by investing in a diversified portfolio instead of cash we have reduced our capital requirement from \$2,500,000 to \$532,482, which is an attractive proposition at face value, but at a cost. The cost is short-term volatility. In the table above, you will notice row 4 "Worst Return over any 12 months"; for a Balanced investor this has been -27.05%. I am sure you will agree that this is a substantial drop in a single year. At the same time, the "Best return over any 12 month period" was 43.96% which is indicative of the potential rally markets can provide in the recovery phase of a significant market downturn such as the GFC and even the current Euro zone Sovereign Debt crisis. The month of October has been a testament to this, with US and Australian Sharemarkets rallying in excess of 10% for the month.

### **Remember this:**

Markets are volatile by nature, and the sacrifice we make as investors is exposing our portfolios to short-term volatility which at times can be extreme. In return for taking this risk, the reward we expect for all the stress, heartache, and second guessing of our investment strategy is higher investment returns than we can achieve from lazy assets such as cash.

Now this may all sound very attractive, but when drawing down income from a portfolio, additional considerations need to be made in the portfolio construction process to ensure that additional shock-proofing is built in. One portfolio does not fit all investors and each portfolio requires tailoring to an individual's unique situation. Further, regular maintenance of any such portfolio is essential in order to ensure that the right balance of growth and defensive assets is maintained. This strategic approach to portfolio construction is just one of many areas in which professional financial advice adds value to any investor's long-term investment strategy.

We are here because cash (for most of us) is not an investment that can deliver sufficient long-term investment returns. As an asset class, cash should be used to temporarily park capital that you know you will need to spend in the next 1-2 years. As investors, we need to consider other factors such as the eroding effect of inflation, fees and taxes, and for most investors a 2% real investment return is insufficient to sustain us through retirement to life expectancy without incurring significant capital drawdown. Risk is inherent in investing and without accepting some degree of investment risk our chances of a sustainable portfolio are diminished.

### **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](mailto:simon.whiteley@eqtsuper.com)**. I look forward to hearing from you.