SEE THE FUTURE

Financial planning without a crystal ball

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Throughout my 20 years of financial planning, I've been told many times, "You didn't predict that, did you?" The premise that as an advisor I should be able to predict the major catalysts that affect investment performance is pure fallacy!

September 11, the collapse of the financial markets and more recently events in Japan have all resulted in global downturns in investment performance. I believe that success in financial management lies in having flexibility and diversity within your investment portfolio. Whether saving on a regular basis for the costs associated with children's education, planning for the inevitability of retirement or investing a capital lump sum to provide a regular income or capital growth, the requirement for competent individual financial advice has never been greater.


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THERE'S NO AVOIDING IT: INVESTING AND RISK GO HAND-IN-HAND

INVESTMENTS WITH GREATER INHERENT RISK MUST PROVIDE HIGHER EXPECTED YIELDS IF INVESTORS ARE TO BE ATTRACTED TO THEM

There's no avoiding it: investing and risk go hand-in-hand. The truth is that risk, in its simplest sense, is the variability of returns.

Risk is a fact of life for any investor. Thanks to inflation, there's even risk in doing nothing. To earn rewards you have to assume some level of risk. If you minimise risk you may also minimise your chance of achieving your goals.

Understanding the level of risk you're willing to take is crucial. It's likely to be one of the first things a financial adviser will ask you about, a process known as risk profiling. This is essential, as the more accurate your risk profile, the greater the chance of recommending the most suitable investments for your needs.

Remember that over time, as your personal circumstances and the economic outlook change, so too might your attitude to risk. So it's essential that you regularly review your investments to make sure they continue to reflect your needs.

THE SINGLE BEST WAY TO PROTECT YOUR PORTFOLIO IS TO SPREAD YOUR RISK ACROSS SEVERAL DIFFERENT TYPES OF INVESTMENT

There are many different assets in which you can invest, each with different risk characteristics. While the risks attributable to assets cannot be avoided, when managed collectively as part of a diversified portfolio that spreads investment funds among classes of securities and localities in order to distribute and control risk, they can be diluted.

WHEN MARKETS ARE TURBULENT, IT'S NATURAL TO BE CONCERNED ABOUT HOW YOUR INVESTMENTS WILL BE AFFECTED. YET WITH SUITABLE LONG-TERM PLANNING, SHORT-TERM MARKET VOLATILITY NEED NOT BE A CONCERN

The latter part of the first decade of the 21st century provided investors with a stark reminder of just how unpredictable stock markets can be. The credit crunch, higher interest rates and a number of other factors saw the markets beset by volatility (the rapid movement of share prices up and down).

The media made much of this volatility, and people were understandably concerned that their investments would lose money. Some financial commentators have forecast more to come, with the risk of a double dip recession, so it's important to understand exactly what market volatility is and why I believe investors should consider such movements a normal and healthy feature of stock market investing.

Stock markets go up and down all the time; this is how they work. Despite this, markets have historically followed an upward trend, even in times of short-term volatility (see chart below). That said, fluctuations both positive and negative can be sudden and dramatic, and may catch even experienced investors off-guard.

In turbulent times, therefore, it's all the more important to understand the fundamentals that underpin stock markets, look beyond short-term volatility and consider market movements with a longer-term perspective.

Timing the market, trying to spot the lowest of the low points and the highest of the highs, is difficult. Diversification, on the other hand, is easy and effective. The starting point is an accurate assessment of your tolerance to risk.

In volatile times you'll feel very exposed unless your portfolio has been crafted around your own personal risk profile.

Picking the right investment is essential to securing performance and successfully riding out volatility. But what is the right investment, and what are the right sectors to invest in? Here again diversification and expertise are key. Investment funds run by professional, well-resourced fund managers can offer a route to both, with the associated benefit of a knowledgeable financial planner. Advice is the key.

The logical response to a volatile market is that it creates good buying opportunities, as shares actually cost less. Investing on a regular basis can further dilute the risk to investment and provide significantly greater returns.

Holding too many assets might be more detrimental to your portfolio than good. If you over-diversify, you might not end up losing much money, but you might be holding back your capacity for growth, as the proportion of your money in different investments will be too small to see much in the way of positive results. The need for sound financial advice has never been more appropriate.

Different markets perform differently at different times, so one of the most effective ways to achieve consistent returns is to spread your money between several different types of assets or markets. This is known as diversification.

Diversification gives you greater potential for growth because your portfolio is not dependent on any one company, fund or sector doing well. So if one of your investments is performing less well, others should be performing better to compensate. This means you reduce your potential risk.

Diversification can be achieved in a number of ways:

By asset class – the simplest form of diversification is spreading your money across equities, bonds, cash and property

By country – investing internationally means you're not limiting your investment to the fortunes of only one country

By industry sectors – consider investing across a variety of sectors such as energy, financial services, industrial and health care

By investment style – creating a balance between funds that concentrate on growth opportunities and others that focus on value stocks, those whose potential has not yet been recognised by the market

EFFECTIVE DIVERSIFICATION

Investing in a range of funds and fund managers provides a simple and effective method of diversification. Because your money is pooled together with that of other investors, each fund is large enough to diversify across hundreds and even thousands of individual companies and assets. What's more, all investment decisions are managed by leading investment experts.

The opportunity to take professional independent financial advice should never be undervalued. Risk awareness and diversity of portfolio are key to the ongoing satisfaction of investors. So when clients say, "You didn't predict that, did you?" – I tell them that we had it covered. §

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If you would like an introduction to Austen Morris Associates or an appointment to discuss savings or investment planning with Matthew, contact us on (021) 6390 1233 or email matthew.r@austenmorris.com.

The fact is, there's no such thing as crystal ball finances.

Different markets perform differently at different times & the most effective way to achieve consistent returns is to spread your money between several different types of assets or markets - diversify.

And to do this, the need for sound financial advice has never been more appropriate.

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