

## Sentiment continues to improve.

While April and May have so far been very positive for shares, investors eyes are still very much focused on the US. Recent GDP numbers and labour market figures give us some indication on where things may be heading.

While US GDP numbers have showed a snail's pace growth for the first quarter of this year, the good news is that the data does not indicate a long and protracted recession. Further, corporate takeover activity seems to have picked up, with Warren Buffet making a bid for Wrigleys and British Gas aggressively bidding for Origin Energy.

US labour markets have also surprised on the upside with unemployment falling marginally further than market expectations.

### What does this mean for you as an investor?

Whilst it may prove to be a false dawn, markets have showed signs of healing since mid-April, with returns from riskier asset classes bouncing back. That said, markets are likely to remain cautious in the near-term as there are still write-offs to come. Also, inflation remains stubbornly high as the world is buffeted by higher food and energy prices.

Still, it is worth keeping in the back of our minds what we have learnt from the past; markets tend to bounce back well before the economic gloom is over. Taking a look at the last nine recessions in the US, we can calculate that the average recession lasted just over 10 months. Interestingly, the average period from the beginning of the recession to the low point in the US **sharemarket** was only four months.

In other words, on average, sharemarkets bottom six months before the end of the recession. This is logical when you consider that most sharemarket investors are likely to be looking forward beyond the current period in

their investment decisions and economic data is reported on a lagged basis.

As the US is now coming to then end of a strong interest rate easing cycle, history shows that this should have a positive effect on sharemarkets over the long-term.

**Rick Maggi**

## The two R's – Eight things you need to remember about risk and return.

### The trade-off.

Typically, investors think about risk or return, some focussing only on maximising returns without measuring the risk taken to achieve those returns. Others are so worried about losing money that they completely avoid risk altogether – which risks reducing their wealth over time. Yet the single most important lesson you can learn is this – **risk and return cannot be separated.**

When it comes to investing, the more risk you take, the higher your potential return. However, there are different types of risk and many change over time or have different implications depending on your time horizon, attitude towards volatility and stage in life. Also, by *managing risk* it may be possible to get more return for a given level of risk.

Risk is the price you pay for returns. Just as the more work you do the more you should be paid, so the more risk you take, the higher return you should receive. This is the 'risk/return trade-off'. It is one of the key concepts of investing.

### Not all risk is bad.

All investments involve risk. However, it is important to distinguish between an investment which is volatile in the short-term but may achieve strong long-term gains, and assets of such poor quality they can never be anything but a bad investment.

Investing in the sharemarket involves day-to-day fluctuations – sometimes extreme ones – but historically have always delivered capital growth over the long term.

When you invest in cash-type investments, the capital you invest is usually deployed conservatively, keeping day-to-day volatility low – and capital returns are limited as a result. When you put your money into shares or property there are a wide range of factors which influence those markets and therefore a much wider dispersion between strong and poor performing investments. You receive a reward (higher returns) for identifying the superior investments.

### **Risk changes over time.**

Time can smooth market volatility. Therefore the amount of investment risk you take on may change significantly depending on how long you are going to hold that investment.

Consider the sharemarket. While day trading may sound very profitable, you are at risk of losing some of your money. History has shown, however, that investing over the medium to longer-term (say five years or more) is far more effective for capital appreciation.

Of course, not everybody has the luxury of time. When investing, it is vital to consider how many years you are investing for. Will you need regular cashflow or some of your money along the way? Only once you are comfortable with this and other issues can you identify investments which carry the appropriate level of risk for you.

### **The risks you don't see and can't control.**

Some risk is invisible. While we hear about swings in company stock prices every day, when it comes to houses, price movements are reported less frequently.

In fact, for many people, the loss or gain associated with a property investment is only really measured when you are selling.

Often it is more frequently traded investments which appear to be more 'risky'. Yet the fact that they are more

liquid makes them less risky. If you need to sell, there is a market with enough demand to provide you with the needed cash. In less liquid markets it can become necessary to significantly reduce the price you are asking to attract a buyer or wait longer for a buyer.

### **Why not taking risk can be risky.**

Many people forget that by not actively seeking exposure to market risk you may be significantly reducing your potential wealth to grow over time.

While storing a pile of money under your mattress may protect you from downturns in the property and sharemarkets, it can still be a risky strategy. As our economy grows, the cost of living increases (inflation) meaning that unless you are growing your savings at least at the same rate, the real value of your money is falling.

Also, without adequate exposure to major assets classes (such as shares and property) you risk missing out on global developments which cause capital growth in investment markets. In the past decade, for example, you would have completely missed out on the investment gains associated with the industrialisation of China and the resources boom, growth from substantial technological developments like the internet and mobile phones and massive booms in both Australian share and property markets.

### **Different people, different risks.**

What's the most important factor when it comes to investment risk? **You.**

Your life-stage and investment time horizon is vital to determining what type of risk you should take on.

While a sharemarket investment may be a relatively low risk long-term investment strategy for a person aged in their 20s – with many years to weather the ups and downs of the market – the same investment may be highly risky for someone counting on the money as they move into retirement.

Different life-stages come with different financial and

family commitments – and this has implications for the risk you can bear. Broadly, the level of investment risk a person takes on will relate to their time horizon, financial and family situation.

### **How to manage risk and achieve independence.**

Diversification – spreading your money around – is one of the most important and effective risk-management tools.

Today, diversification involves blending the right combination of asset classes (shares, property, bonds, cash etc) and also diversifying across a variety of managers and countries.

The ‘right’ kind of diversification again depends on you. You want to build a diversified portfolio that helps you seek your desired long-term return goals but within risk boundaries you are comfortable with. Your risk management checklist should ask the following questions... **Have you a clear long-term goal? Do you have the capacity to balance and rebalance your investments? What’s your timeframe?**

**Financial independence** = building personal cashflow, to replace your employment cashflow, to meet your cost of living cash flow.

### **Who can help you?**

We can. We can help you make a detailed assessment of your financial situation, investment time horizon and life stage. We can also help you to select products and strategies which match your risk profile and return objectives.

‘The policy of being too cautious is the greatest risk of all’

Jawaharlal Nehru (1889-1969)

## **Make a will, now.**

Did you know that roughly half of Australians die without leaving a valid will? Are you aware that rules contained in legislation would decide how your assets are distributed? Are you going to leave your loved ones with wealth and assets or legal costs and tax bills? Without an up-to-date will, your estate may be left in limbo, instead of providing your loved ones with security after you are gone.

## **The importance of insurance.**

No matter how comprehensive and successful your investment plan may be, the most important asset you and your family have is your health. Without it, you lose your ability to provide for yourself and your family on a day-to-day basis, let alone achieve your long-term goals.

Being injured, or worse, dying prematurely, are subjects we would prefer to keep at the back of our minds. By taking out life, trauma or disability income insurance, you can afford to concentrate on living, knowing that if the worst happens, you and your family will be protected.

To ensure that your plans remain on track and your family’s financial wellbeing is safeguarded, please make sure that you are adequately protected. If you are in doubt or if you would simply like a competitive insurance quotation, please contact **Jenny Halberg**.

## **June 30: Window of opportunity.**

As discussed in our April newsletter, there are many issues to consider before June 30<sup>th</sup>. With the end of the financial year fast approaching, now is usually a good time to review your investment, superannuation, taxation and/or retirement strategies. So if you haven’t already done so, please contact our office to arrange an appointment, or alternatively, please discuss these issues with your accountant.

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