INFORMED INVESTOR

November 2023

threePILLARS
wealth management

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Welcome to the November edition of our quarterly newsletter, Informed Investor.

ECONOMIC UPDATE

October was another difficult month for financial markets, partly reflecting an acceptance among investors that interest rates are likely to remain high for longer than was previously anticipated.

Geopolitical risk ramped up too, following conflict in Israel and Palestine.

Australian shares were down nearly 4% over the month and overseas stock markets closed lower too, not helped by a third consecutive monthly decline in the S&P 500 Index in the US.

Rising government bond yields once again acted as a headwind for fixed income. Major bond indices closed October lower, both in Australia and offshore.

The gold price also highlighted investors' general risk aversion, rising in value by more than 7%. Historically, gold prices have tended to rise during periods of heightened uncertainty.

Cryptocurrencies also tended to fare well, again highlighting their low correlation with other financial assets. Bitcoin values rose nearly 30% over the month, for example, and have now more than doubled in the calendar year to date.

Continued over...

FURTHER INFORMATION

Julian Payne

Three Pillars Wealth Management

P: 02 4969 8402

E: julian@threepillarswealth.com.au

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Capstone
FINANCIAL PLANNING

ECONOMIC UPDATE CONTINUED

AUSTRALIA

Speaking at her first public event since taking over as the Governor of the Reserve Bank of Australia, Michele Bullock suggested Australians might not have seen the end of the interest rate hiking cycle.

Minutes from the Reserve Bank's latest meeting were similarly sobering, noting that the "Board has a low tolerance for a slower return of inflation to target than currently expected". Policymakers increased the interest rate by a further 0.25% on 7 November.

The CPI print for the September quarter (+5.2% year-on-year) showed a moderation in inflation from the June quarter, but came in above consensus forecasts. Again, this was concerning given the link between inflation and monetary policy settings.

NEW ZEALAND

Attention was focused on the political scene in New Zealand, after Christopher Luxon's National Party won 39% of the vote in the general election.

Luxon was in talks with other parties – including the ACT Party and the New Zealand First Party – in the remainder of the month to try and form a coalition government.

Annual inflation for the three months ending 30 September showed a moderation from the June run-rate and also came in below consensus forecasts. No further increases in interest rates are currently anticipated.

US

The US economy remains resilient and appears reasonably unaffected by significant increases in interest rates. The economy grew at its fastest pace in nearly two years in the September quarter, boosted by higher consumer spending.

The labour market in the US remains buoyant, which appears to be supporting confidence levels and discretionary expenditure.

Non-farm payrolls increased by 336,000 in September, which was nearly double the consensus forecast and the highest monthly total since January.

Consumer prices in the US are still rising at an annual pace of 3.7%, which is above the Federal Reserve's target. Officials maintain that inflation is still too high and that further increases in official interest rates cannot be ruled out.

EUROPE

Borrowers were relieved to see a further moderation in inflation in the Eurozone, as it reduced the likelihood of further interest rate hikes in the region.

Consumer prices rose 4.3% in the year ending 30 September. This was the slowest pace for nearly two years, albeit still more than double the European Central Bank's 2% target.

Some of the latest economic indicators in Germany improved. Factory orders rose by 3.9% in August, raising hopes that overall activity levels in Europe's largest economy could be rising. A negative GDP growth reading for the calendar year remains a possibility, however, which would undoubtedly dampen the growth rate in the broader Eurozone.

Despite the ongoing economic weakness in Germany, the country looks likely to replace Japan as the world's third-largest economy by the end of this year.

According to the International Monetary Fund, Germany's GDP will exceed Japan's in USD terms in 2023, partly owing to weakness in the Japanese yen against the US dollar.

At a rate of 6.7% year-on-year, inflation in the UK remained stubbornly high in September. This prompted suggestions that the Bank of England might need to raise interest rates further.

There were mixed signals on the labour front in the UK. Overall employment fell by more than 80,000 in the three months to the end of August, but wage growth continued to quicken and is now outpacing inflation, in turn increasing the purchasing power of employees.

ASIA

Chinese GDP growth data for the September quarter released in October and were somewhat better than anticipated.

The Chinese economy grew at an annualised rate of 4.9% during the three-month period, boosted by an improvement in consumer spending and retail sales.

Notably, electricity consumption rose nearly 10% during the quarter, suggesting activity levels in the manufacturing sector might have picked up.

That said, problems in the property sector are persisting and some of the country's largest developers have defaulted on their debt repayments. The knock-on effects of these failures could have an adverse influence on the economy and might jeopardise the official annual GDP growth target of 5%.

With that in mind, we could see a further easing in policy settings in the months ahead as authorities in Beijing try to ensure their growth targets are achieved.

Elsewhere, reports suggested the Bank of Japan is preparing to announce additional spending of around 22 trillion yen (more than AUD200 billion). It appears that authorities are trying to cushion the impact of rising inflation on households and stimulate economic activity levels.

AUSTRALIAN DOLLAR

With the 'risk off' tone extending across most markets globally, the Australian dollar continued to weaken against the US dollar.

The AUD declined by a further 1.5% (around 1 US cent) against the USD, closing October slightly over 63 US cents.

The AUD performed similarly against a trade-weighted basket of international currencies (-1.5%), but was little changed against selected Asian currencies including the Japanese yen.

AUSTRALIAN EQUITIES

AGM season kicked off for ASX-listed companies, but like in other major share markets globally, sentiment was adversely affected by escalating geopolitical uncertainty in the Middle East. The S&P/ ASX 200 Accumulation Index ended October 3.8% lower.

Utilities (+1.7%) was the only sector to finish the month in positive territory, partly thanks to a solid contribution from Origin Energy (+4.0%).

The Materials sector was another relative outperformer, falling 'only' 0.8%. Gold miners including Silver Lake Resources (+24.3%), Gold Road Resources (+17.0%) and Regis Resources (+16.1%) benefited from the rising gold price. Gold has historically been perceived as a 'safe haven' asset and can appreciate during periods of economic and/or geopolitical uncertainty.

Mixed earnings results from large US tech names dampened sentiment towards the IT sector (-7.6%). Weebit Nano (+4.1%) was the only stock in this area of the market to make positive progress – the announcement of a new commercial agreement with DB HiTek and the company's first quarter activities report were well received by investors.

All Healthcare (-7.2%) stocks in the ASX 200 fell over the month. Telix Pharmaceuticals and Healius were among the worst performers, both falling by more than 20%.

Small caps typically underperformed their large cap peers, with the S&P/ASX Small Ordinaries Index falling 5.5%.

The Small Financials sector (-13.1%) was the worst performing area of the market, partly owing to disappointing performances from Credit Corp, Tyro Payments and Magellan. All three of these stocks lost around a third of their value.

GLOBAL EQUITIES

Persistent talk of a slowdown in economic growth rates as higher interest rates are digested, is hindering share markets.

The MSCI World Index declined by 1.0% in Australian dollar terms. Returns were worse still in local currency terms.

In the US, the S&P 500 Index fell 2.1% – the third consecutive monthly decline. The Index has not had such a long losing run since March 2020, around the beginning of the COVID pandemic.

The S&P 500 Index has not fallen for four consecutive months for more than a decade and will hopefully avoid repeating this with a positive return in November.

Generally speaking, third-quarter earnings released by listed companies in the US were underwhelming. This added to concerns over potential implications of fresh conflict in the Middle East and saw investors rein in their appetite for risk.

It was a similarly downbeat story elsewhere, with most large share markets in Asia and Europe closing October 3% to 4% lower.

In Japan, the Nikkei registered its fourth consecutive monthly drop (the first time this has occurred for more than a decade) and Chinese shares fell in both China and Hong Kong.

Switzerland was the worst performer in Europe, with the SMI closing the month down more than 5%.

The weakness extended to emerging regions too. The MSCI Emerging Markets Index lost nearly 4% of its value in local currency terms and returned -2.0% in AUD.

LISTED PROPERTY

Global property securities struggled in October, consistent with weakness in broader share markets.

The FTSE EPRA/NAREIT Developed Index returned -4.5% in Australian dollar terms.

Concerns that inflation will be sticky in nature and see interest rates remain higher for longer dampened sentiment towards REITs. The latest CPI data in the UK and Canada, for example, highlighted the general persistence of inflationary pressure in key regions.

The increase in geopolitical tensions was also unhelpful and all major markets saw declines over the month.

Spain (-1.6%) and France (-2.4%) fared better than most. Generally speaking, European markets held up relatively well given the encouraging moderation in inflation in the region.

J-REITs in Japan also outperformed most global peers.

Laggards over the month included Canada (-7.4%), Singapore (-6.4%) and Hong Kong (-6.3%).

GLOBAL AND AUSTRALIAN FIXED INCOME

The sharp sell-off in global fixed income markets continued as bond yields trended higher in all major regions.

Yields on 10-year government bonds in the US breached the 5% threshold in mid-October, for the first time since 2007 before the Global Financial Crisis. Treasury yields closed the month up 0.36%, to 4.93%, as investors accepted that borrowing costs are likely to remain high for an extended period.

The upward move in Treasury yields acted as a strong headwind for the performance of global bonds. The Bloomberg Global Aggregate Index (AUD hedged) returned -1.9%.

Yields on 10-year Japanese Government Bonds rose 0.18% over the month. Since yields were just 0.76% at the beginning of October, this was an extraordinarily large move.

By month end, yields were hovering not too far below the Bank of Japan's revised 1.00% upper limit. The central bank might therefore be required to intervene and support the bond market if selling pressure persists and if yields continue to rise.

Sovereign bond markets in Europe were more stable, with benchmark 10-year yields rising only 0.07% in the UK and closing the month slightly lower in Germany.

Moves in the Australian market were even more extreme than in the US.

Yields on 10-year Australian Commonwealth Government Bonds rose 0.44% over the month, following the release of generally resilient economic data and the high inflation print for the September quarter.

Yields on shorter-dated bank bills rose too, which lifted the prospective returns from cash and other AUD-denominated short-term investments.

GLOBAL CREDIT

Economic indicators remain quite resilient in most regions, which augurs well for activity levels and corporate profitability. On the other hand, there is still a risk that interest rates could be raised further, in turn increasing borrowing costs for companies.

Combined with some lacklustre quarterly earnings releases from US-listed firms, concerning developments in the Middle East saw investors moderate their risk appetite. Credit spreads widened against this background, which was a headwind and prevented corporate bonds from making more meaningful progress.

Global credit still managed to generate a small positive return however, thanks to the receipt of regular coupon income.

Combined with credit spreads that have been reasonably stable recently, higher risk-free rates have significantly increased prospective returns from credit. As a result the asset class has enjoyed inflows from income-oriented investors, in particular.

Source: First Sentier Investors

SEVEN KEY CHARTS FOR INVESTORS TO KEEP AN EYE ON

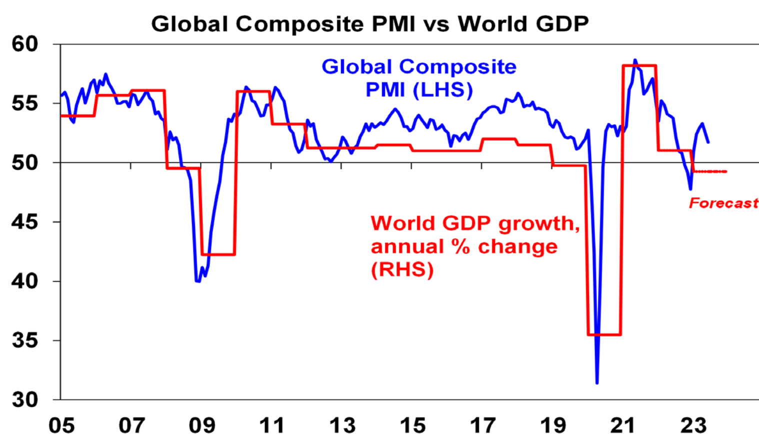
INTRODUCTION

At the start of this year, we thought shares would have reasonable returns albeit it wouldn't be smooth sailing given ongoing issues around inflation, interest rates, the risk of recession and geopolitics. So far so good. This note updates seven key charts we see as critical for the investment outlook.

CHART 1 – GLOBAL BUSINESS CONDITIONS PMIS

A big determinant of whether share markets can move higher or resume the bear market in US and global shares that started last year, will be whether major economies slide into recession and, if so, how deep that is. Our assessment is that the risk of a mild recession is high (particularly in Australia), but that at least a deep recession should be avoided. Global business conditions indexes (PMIs) – which are surveys of purchasing managers at businesses – will be a key warning indicator.

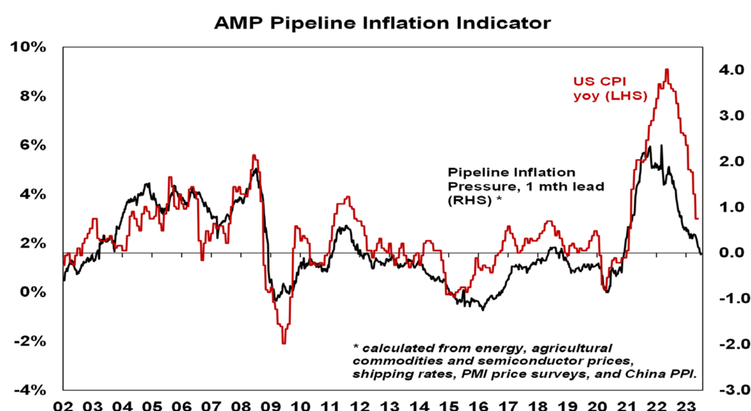
So far, they have proven resilient. While slowing again after a bounce – partly due to China – they are at levels consistent with okay global growth.



Source: Bloomberg, AMP

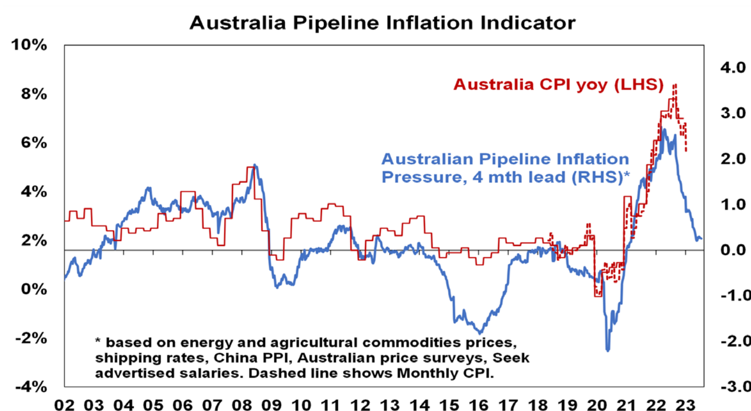
CHART 2 (AND 2B) – INFLATION

Of course, a lot continues to ride on how far key central banks raise interest rates. And as has been the case for the last 18 months or so the path of inflation will play a key role in this. Over the last six months the news on this front has continued to improve with inflation rates in key countries rolling over. US inflation has now fallen from 9.1% YOY a year ago to 3% in June and our US Pipeline Inflation Indicator – reflecting a mix of supply and demand indicators – continues to point to a further decline. This reflects a combination of lower commodity prices, improved supply, lower transport costs and easing demand. Just as goods price inflation led on the way up, it's now leading on the way down with services inflation rolling over as well.



Source: Bloomberg, AMP

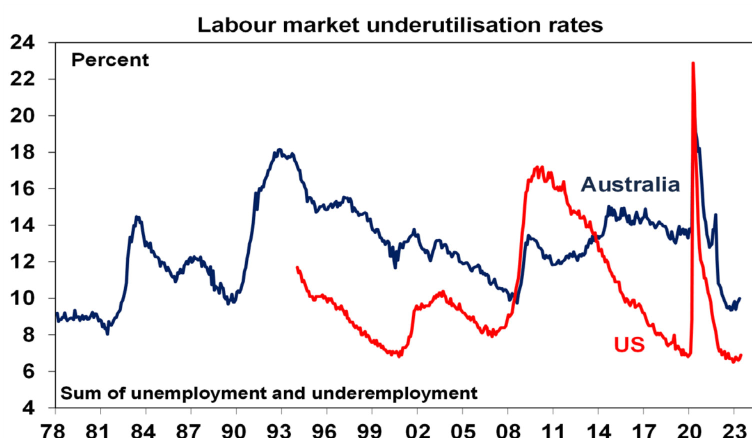
Australian inflation is lagging the US by 6 months, but our Australian Pipeline Inflation Indicator suggests inflation here will continue to fall, even though we did see a rise in the September quarter of 1.2 per cent due to the uncertainty brought on by the Israel and Palestine conflict. The RBA has maintained its position in holding rates higher for longer to stop inflation. Our assessment is that the RBA is close to the top with rate cuts starting in February next year.



Source: Bloomberg, AMP

CHART 3 – UNEMPLOYMENT AND UNDEREMPLOYMENT

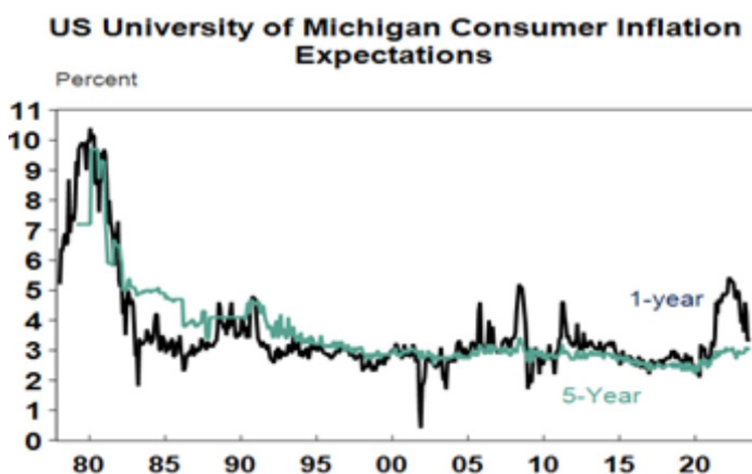
Also critical is the tightness of labour markets as this will determine wages growth which has a big impact on services inflation. If wages growth accelerates too much in response to high inflation, it risks locking in high inflation with a wage-price spiral which would make it harder to get inflation down. Unemployment and underemployment are key indicators of whether this will occur or not. Both remain low in the US and Australia (putting upwards pressure on wages), but there is increasing evidence that labour markets are cooling. Wages growth is still rising in Australia (with the announcement effect of faster increases in minimum and award wages adding to this) but wages growth in the US looks to have peaked.



Source: Bloomberg, AMP

CHART 4 – LONGER TERM INFLATION EXPECTATIONS

The 1970s experience tells us the longer inflation stays high, the more businesses, workers and consumers expect it to stay high and then they behave in ways that perpetuate it – in terms of wage claims, price setting and tolerance for price rises. The good news is that short term (1-3 years ahead) inflation expectations have fallen sharply and longer term inflation expectations remain in the low range they have been in for the last three decades. This is very different from 1980 when inflation expectations were around 10% and a deep recession was required to get inflation back down.

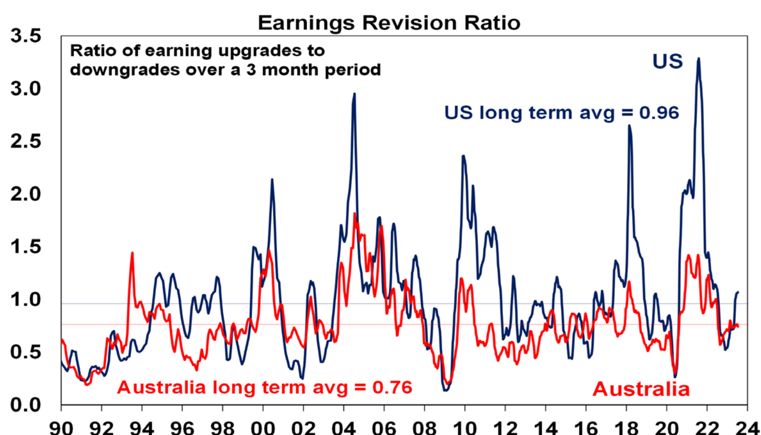


Source: Macrobond, AMP

CHART 5 – EARNINGS REVISIONS

Consensus US and global earnings growth expectations for this year have been downgraded to around zero with a 10% rise next year and for Australia the consensus expects a 3% fall this financial year.

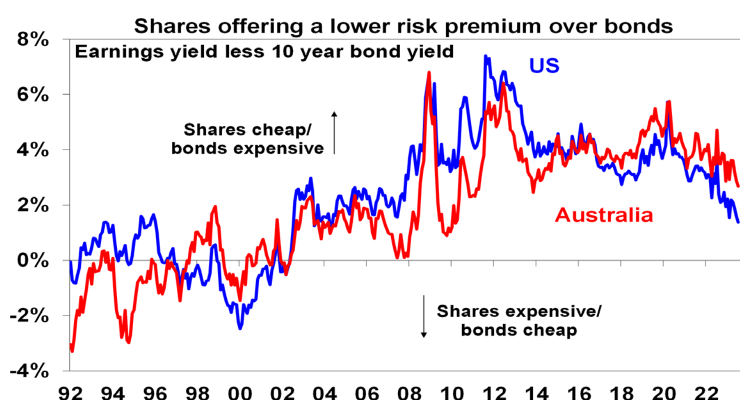
A recession resulting in an earnings slump like those seen in the early 1990s, 2001-03 in the US and 2008 would be the biggest risk but recently revisions to earnings expectations have been moving up.



Source: Reuters, AMP

CHART 6 – THE GAP BETWEEN EARNINGS AND BOND YIELDS

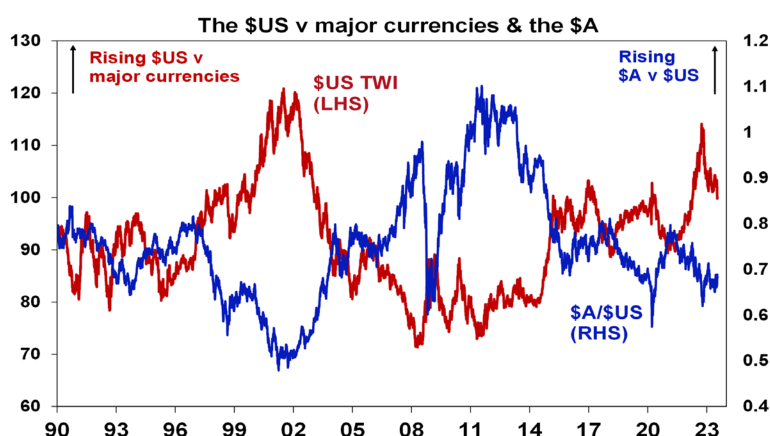
Since 2020, rising bond yields have weighed on share market valuations. As a result, the gap between earnings yields and bond yields (which is a proxy for shares' risk premium) has narrowed to its lowest since the GFC in the US and Australia. Compared to the pre-GFC period shares still look cheap relative to bonds, but this is not the case compared to the post GFC period suggesting valuations may be a bit of a constraint to share market gains as current uncertainties suggests investors may demand a risk premium over bonds similar to that seen post GFC as opposed to what was seen pre GFC. Australian share valuations look a bit more attractive than those in the US though helped by a higher earnings yield (or lower PEs). Ideally bond yields need to decline and earnings downgrades need to be limited.



Source: Reuters, AMP

CHART 7 – THE US DOLLAR

Due to the relatively low exposure of the US economy to cyclical sectors (like manufacturing), the $US tends to be a "risk-off" currency. In other words, it goes up when there are worries about global growth and down when the outlook brightens. An increasing $US is also bad news for those with $US denominated debt in the emerging world. So, moves in it bear close watching as a key bellwether of the investment cycle. Last year the $US surged with safe haven demand in the face of worries about recession, war and aggressive Fed tightening. Since September though it has fallen back as inflation and Fed rate hike fears eased and geopolitical risks receded. And after stalling over the last six months, it's since broken down again. A further downtrend in the $US would be a positive sign for investment markets this year, whereas a sustained new upswing would suggest they may be vulnerable. So far it's going in the right direction.



Source: Bloomberg, AMP

Source: AMP

THREE REASONS TO ERR ON THE SIDE OF OPTIMISM AS AN INVESTOR

INTRODUCTION

The "news" as presented to us has always had a negative bend, but one could be forgiven for thinking that it's become even more negative with constant stories of disasters, conflict, wrongdoing, grievance and loss. Consistent with this it seems that the worry list for investors is more threatening and confusing. This was an issue prior to coronavirus – with trade wars, social polarisation, tensions with China, worries about job loss from automation and ever-present predictions of a new financial crisis. Since the pandemic higher public debt, inflation, geopolitical tensions and rising alarm about climate change have added to the worries. These risks can't be ignored but it's very easy to slip into a pessimistic perspective regarding the outlook. However, when it comes to investing the historical track record shows that succumbing too much to pessimism doesn't pay.

THREE REASONS WHY WORRIES MIGHT SEEM MORE WORRYING

Some might argue that since the GFC the world has become a more negative place and so gloominess or pessimism is justifiable. But given the events of the last century – ranging from far more deadly pandemics, the Great Depression, several major wars and revolutions, numerous recessions with high unemployment and financial panics – it's doubtful that this is really the case viewed in the long term sweep of history.

There is no denying there are things to worry about at present – notably inflation, political polarisation, less rational policy making and geopolitical tensions – and that these may result in more constrained investment returns. But there is a psychological aspect to this combining with greater access to information and the rise of social media to magnify perceptions around worries. All of which may be adding to a sense of pessimism.

Firstly, our brains are wired in a way that makes us natural receptors of bad news. Humans tend to suffer from a behavioural trait known as "loss aversion" in that a loss in financial wealth is felt much more negatively than the positive impact of the same sized gain. This probably reflects the evolution of the human brain in the Pleistocene age when the key was to avoid being eaten by a sabre-toothed tiger or squashed by a woolly mammoth. This left the human brain hard wired to be on guard against threats and naturally risk averse. So, we are more predisposed to bad news stories as opposed to good. Consequently, bad news and doom and gloom find a more ready market than good news or balanced commentary as it appeals to our instinct to look for risks. Hence the old saying "bad news and pessimism sells". This is particularly true as bad news shows up as more dramatic whereas good news tends to be incremental. Reports of a plane (or a share market) crash will be far more newsworthy (generating more clicks) than reports of fewer plane crashes this decade (or a gradual rise in the share market) ever will. As a result, prognosticators of gloom are more likely to be revered as deep thinkers than optimists. As English philosopher and economist John Stuart Mill noted "I have observed that not the man who hopes when others despair, but the man who despairs when others hope, is admired by a large class of persons as a sage."

Secondly, we are now exposed to more information on everything, including our investments. We can now check facts, analyse things, sound informed easier than ever. But for the most part we have no way of weighing such information and no time to do so. So, it's often noise. As Frank Zappa noted "Information is not knowledge, knowledge is not wisdom". This comes with a cost for investors. If we don't have a process to filter it and focus on what matters, we can suffer from information overload. This can be bad for investors as when faced with more (and often bad) news, we can freeze up and make the wrong decisions with our investments. Our natural "loss aversion" can combine with what is called the "recency bias" – that sees people give more weight to recent events in assessing the future – to see investors project recent bad news into the future and so sell after a fall. As famed investor Peter Lynch observed "Stock market news has gone from hard to find (in the 1970s and early 1980s), then easy to find (in the late 1980s), then hard to get away from".

Thirdly, there has been an explosion in media competing for attention. We are now bombarded with economic and financial news and opinions with 24/7 coverage by multiple websites, subscription services, finance updates, dedicated TV and online channels, chat rooms and social media. This has been magnified as everything is now measured with clicks – stories (and reporters) that generate less clicks don't get a good look in. To get our attention, news needs to be entertaining and, following from our aversion to loss, in competing for our attention, dramatic bad news trumps incremental good news and balanced commentary. So naturally it seems the bad news is "badder" and the worries more worrying than ever which adds to a sense of gloom. The political environment has added to this with politicians more polarised and more willing to scare voters.

Google the words "the coming financial crisis" and it's teeming with references – 270 million search results at present – and as you might expect many of the titles are alarming:

"A recession worse than 2008? How to survive and thrive".

"Could working from home cause the next financial crisis?"

"Economic crash is inevitable".

"Three men predicted the last financial crisis – what they're warning of now is terrifying".

"How China's debt problem could trigger a financial crisis".

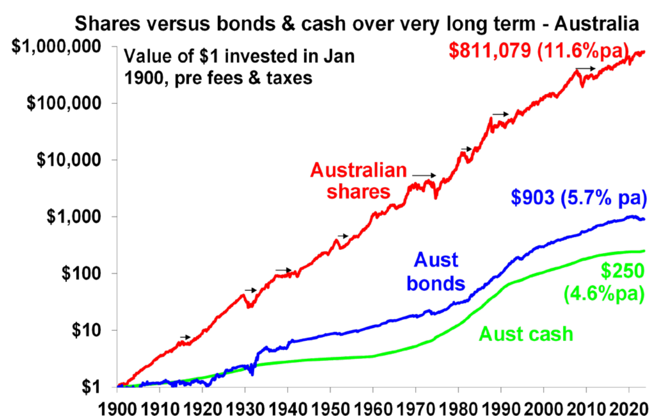
People have always been making gloomy predictions of "inevitable" and "imminent" economic and/or financial disaster but prior to the information explosion and social media it was much harder to be regularly exposed to such disaster stories. The danger is that the combination of the ramp up in information and opinion, combined with our natural inclination to zoom in on negative news, is making us worse investors: more distracted, pessimistic, jittery and focused on the short term.

THREE REASONS TO BE OPTIMISTIC AS AN INVESTOR

There are three good reasons to err on the side of optimism as an investor.

Firstly, without a degree of optimism there is not much point in investing. As the famed value investor, Benjamin Graham pointed out: "To be an investor you must be a believer in a better tomorrow". If you don't believe the bank will look after your deposits, that most borrowers will pay back their debts, that most companies will see rising profits over time supporting a return to investors, that properties will earn rents, etc. then there is no point investing. To be a successful investor you need to have a reasonably favourable view about the future.

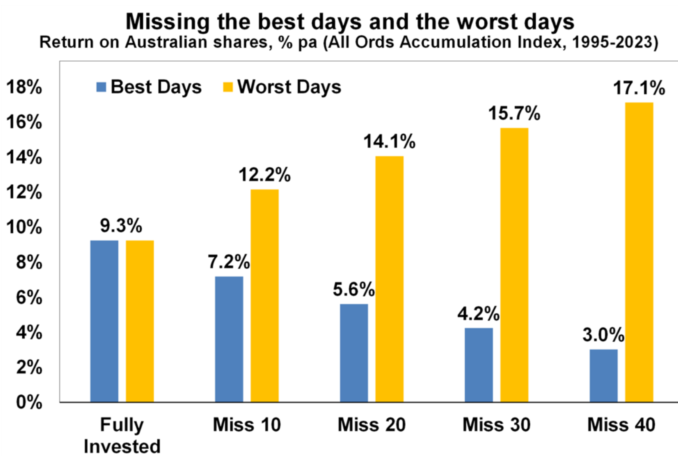
Secondly, the history of share markets (and other growth assets like property) in developed, well managed countries, with a firm commitment to the rule of law, has been one of the triumph of optimists. Sure, share markets go through bear markets and often lengthy periods of weakness – where pessimists get their time in the sun – but the long term trend has been up, underpinned by the desire of humans to find better ways of doing things resulting in a real growth in living standards. This is indicated in the next chart which tracks the value of $1 invested in Australian shares, bonds and cash since 1900 with dividends and interest reinvested along the way. Cash is safe and so fine if you are pessimistic but has low returns, and that $1 will have only grown to $250 today. Bonds are better, and that $1 will have grown to $903. Shares are volatile (and so have rough periods – see the arrows) but if you can look through that, they will grow your wealth and that $1 will have grown to $811,079.



Source: ASX, Bloomberg, RBA, AMP

This does not mean blind optimism where you get sucked in with the crowd when it becomes euphoric or into every new whiz bang investment obsession that comes along (like Bitcoin or the dot com stocks of the 1990s). If an investment looks too good to be true and the crowd is piling in, then it probably is – particularly if the main reason you are buying in is because of huge recent gains. So, the key is cautious, not blind, optimism.

Finally, even when it might pay to be pessimistic and hence out of the market in corrections and bear markets, trying to get the timing right can be very hard. In hindsight many downswings in markets like the GFC look inevitable and hence forecastable, and so it's natural to think you can anticipate downswings going forward. But trying to time the market – in terms of both getting out ahead of the fall and back in for the recovery – is difficult. A good way to demonstrate this is with a comparison of returns if an investor is fully invested in shares versus missing out on the best (or worst) days. The next chart shows that if you were fully invested in Australian shares from January 1995, you would have returned 9.3% pa (with dividends but not allowing for franking credits, tax and fees).

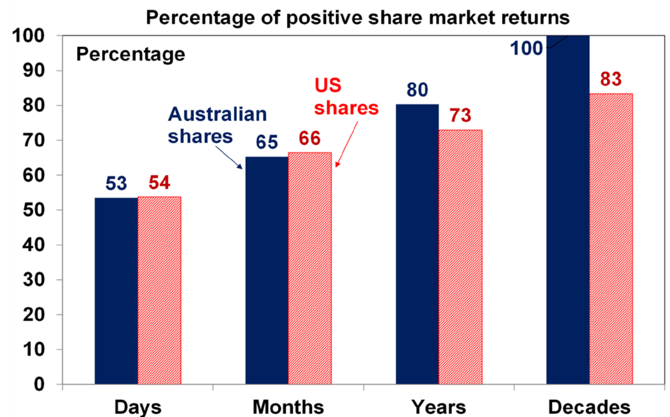


Covers Jan 1995 to March 2023.
Source: Bloomberg, AMP

If you were pessimistic about the outlook and managed to avoid the 10 worst days (yellow bars), you would have boosted your return to 12.2% pa. And if you avoided the 40 worst days, it would have been boosted to 17.1% pa! But this is very hard, and many investors only get really pessimistic and get out after the bad returns have occurred, just in time to miss some of the best days. For example, if by trying to time the market you miss the 10 best days (blue bars), the return falls to 7.2% pa. If you miss the 40 best days, it drops to just 3% pa.

As Peter Lynch has pointed out "More money has been lost trying to anticipate and protect from corrections than actually in them".

On a day to day basis it's around 50/50 as to whether shares will be up or down, but since 1900, shares in the US have had positive returns around seven years out of ten and in Australia it's around eight years out of ten.



Daily and monthly data from 1995, data for years and decades from 1900. Source: ASX, Bloomberg, AMP

So, getting too hung up in pessimism on the next crisis that will, on the basis of history, drive the market down in two or three years out of ten may mean that you end up missing out on the seven or eight years out of ten when the share market rises. Here's one final quote to end on.

> **"No pessimist ever discovered the secrets of the stars, or sailed to an uncharted land, or opened a new heaven to the human spirit".**
>
> **– Helen Keller**

Source: AMP

THE IMPORTANCE OF REBALANCING

Investing is more than choosing different assets. It also involves managing your portfolio on an ongoing basis to achieve personal goals.

YOUR STARTING POINT

In the initial stages of constructing a portfolio of diverse investments, it is likely you will have made a deliberate decision about how much money to hold in different asset classes.

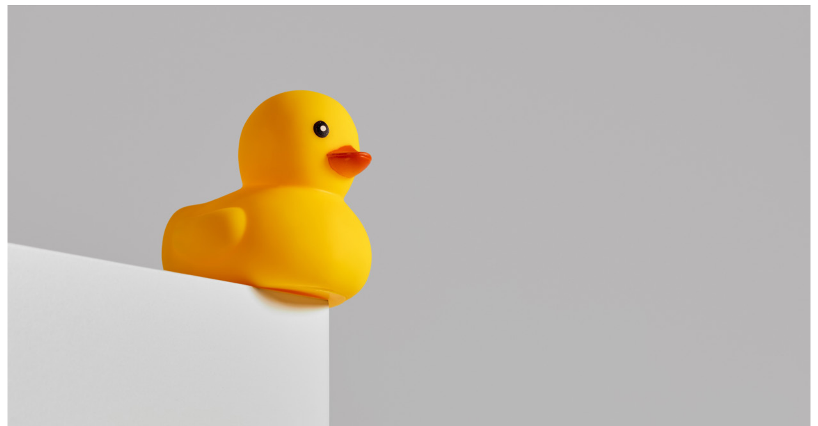
ASSET CLASS	HOLDING %
Cash	10
Fixed interest	15
Property securities	20
Australian shares	35
International shares	20
	100%

The way your portfolio is spread across different assets is known as your "asset allocation". Over time, movements in investment markets can mean your asset allocation changes, perhaps significantly, even though you haven't actively changed the weightings yourself.

For example*, if share markets streak ahead, the relative value of your shareholdings may increase quicker than the rest of your investments, so over time the value of your portfolio could look more like this:

ASSET CLASS	% (start)	% (later)
Cash	10	5
Fixed interest	15	10
Property securities	20	15
Australian shares	35	45
International shares	20	25
	100%	100%

* This example has been provided for illustrative purposes only.



It may seem that the increase in shares as a proportion of your portfolio is a good thing. However as shares are a higher risk asset, this also means that the overall risk level of your portfolio may have increased beyond a level you are comfortable with. Unless you are happy to take on more risk, it may make sense to rebalance.

REBALANCING YOUR PORTFOLIO

The process of rebalancing typically involves bringing a portfolio that has changed in value, back to the initial asset weightings you had in place at the start. This can be done by selling some investments and purchasing more of those underrepresented investments.

Yes, the process of rebalancing means you may incur capital gains tax on any profits made on sale of some investments. But if you don't rebalance, you may find yourself overexposed to a market fall in one particular asset class.

It is worth reviewing your portfolio on a regular basis to see if rebalancing is necessary.

PROFESSIONAL SUPPORT WITH REBALANCING

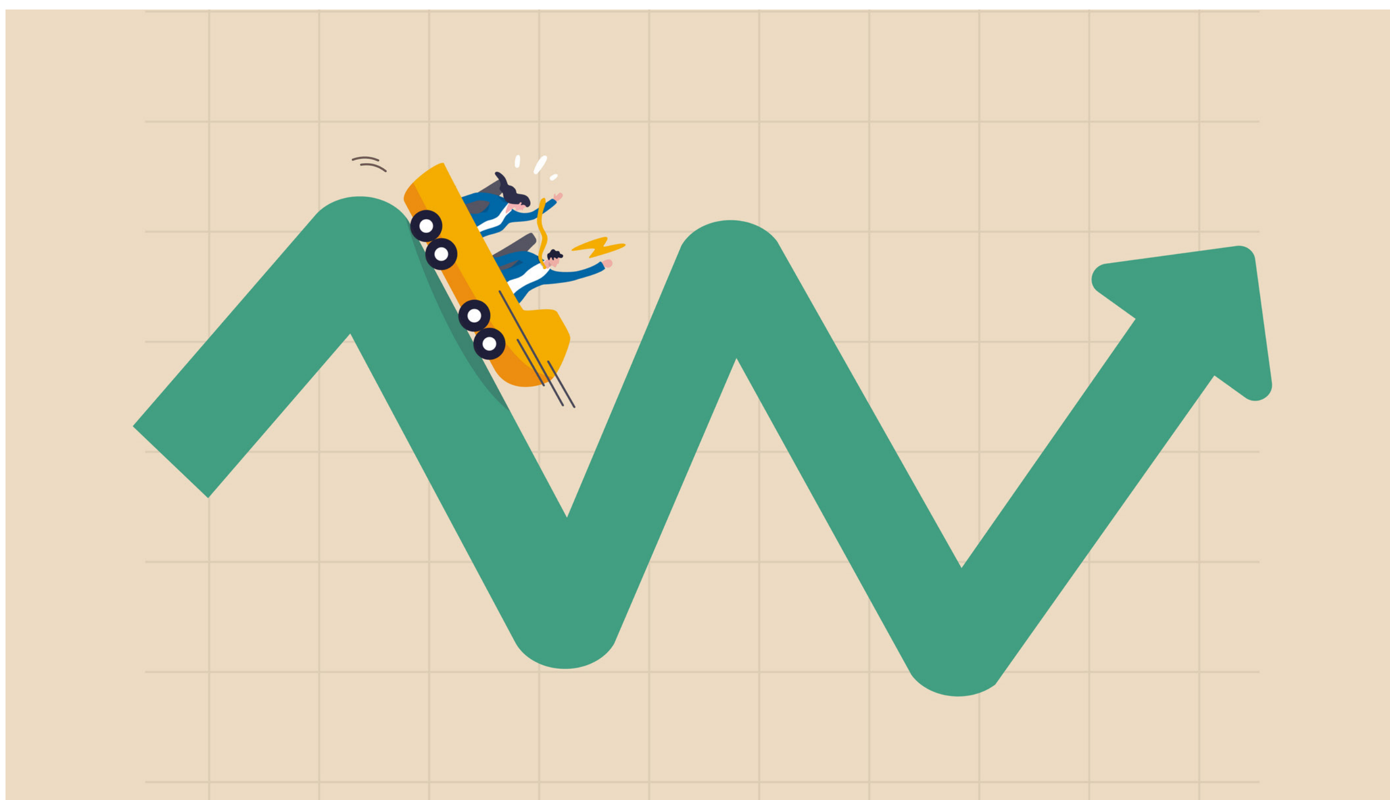
If the idea of reviewing your portfolio and taking active steps to rebalance the weightings on a regular basis sounds like hard work, one option is to use a managed investment where the asset allocations are set and a professional investment manager does all the rebalancing on your behalf.

Source: BT

[1] https://www.bt.com.au/personal/investments/learn/managing-your-investments/the-importance-of-rebalancing.html

UNDERSTANDING MARKET VOLATILITY

Many investors become concerned when volatility occurs in global financial markets – particularly about the impact on their superannuation and other investments. In times like these, it's important to understand the causes of market movements and how to minimise your risk.



WHY DO MARKETS MOVE SO MUCH?

Markets are influenced by many things – industrial, economic, political and social factors can all have an impact. For example, consumer and business confidence affect spending and therefore company profits.

Global trade and production naturally affect economic growth. Poor political and fiscal decisions in some countries may lead to a flow on effect in other countries who are owed money. And of course, natural disasters can cause major damage to any economy with no warning.

During times of market volatility, it's important to remember one of the fundamental principles of investing – markets move in cycles.

WHAT IS THE EFFECT OF MARKET VOLATILITY ON SUPER FUNDS?

In times of market volatility your super balance may decline but it is important to remember that markets move in cycles. Volatility is a natural part of the economic cycle. Markets are influenced by a range of factors and are inherently unpredictable.

The Australian Securities & Investments Commission (ASIC) states that, 'negative returns from time to time are not inconsistent with successful long term investment'. History demonstrates that over the long term, the general trend of share markets has been upward.

DON'T LOSE SIGHT OF THE BIGGER PICTURE

Super is a long term investment. Shares, which usually form a large part of most balanced super accounts, are also generally a long term investment. They are designed to provide capital growth over a period of five years or more. Think in years, not days.

The time frame for super may be 20 years or more, so short term volatility shouldn't diminish the long term potential of your investments. Growth assets (such as shares) tend to fluctuate in the short term but have historically provided excellent returns for investors over the long term.

When sharemarkets fall in value, it may be tempting to sell up. However, trying to time the market by selling now and buying back later is a risky strategy that rarely results in investors coming out ahead. By taking a long term view of investing, you can ride out any short term fluctuations in the market and take advantage of growth opportunities over the long term.

DIVERSIFICATION

Diversification is one of the most effective ways of managing volatility. It can help deliver smoother, more consistent results over time. Your investment may benefit by being spread across a variety of asset classes, including shares (domestic and global), fixed income, cash, direct and listed property and alternatives.

This diversification should help soften the effects of any sharemarket falls as some asset classes often tend to do well whilst others are struggling. Also, spreading your assets around means you are less reliant on any one asset class at any particular time.

UNDERSTAND YOUR RISK PROFILE

All investments carry some risk. How much risk you're willing to accept will be influenced by your financial situation, family considerations, time horizon and even your personality. If market volatility has caused you to reassess the way you feel about risk, it's important that you see your financial adviser to discuss any necessary changes to your financial plan.

UNDERSTANDING THE IMPLICATIONS OF WITHDRAWING

Before you withdraw from an investment you should understand all the implications, risks and costs involved.

Locking in your losses. If the value of your investment is falling, you are technically only making a loss on paper. A rise in prices could soon return your investment to profit without you doing anything. Selling your investment makes any losses real and irreversible.

Incurring capital gains tax (CGT). Make sure you know what your CGT position will be before selling any asset.

Losing the benefits of compounding. If you're thinking about making a partial withdrawal from an investment, remember that it's not just the withdrawal you lose but all future earnings and interest on that amount.

KEY TAKEAWAYS

Keep in mind that:

- Super is a long term investment designed to generate sufficient money so you can enjoy your retirement.
- Diversification is an important part of a long term super investment strategy. To create the lifestyle you want in retirement, it may be necessary to invest in growth assets like shares so that your returns stay ahead of tax and inflation.
- It may be beneficial to ride out the bad times in order to achieve long term growth.

Your financial plan was designed exclusively for you to suit your investment objectives and risk profile. It's important to stay focused on your long term goals.

Source: Colonial First State