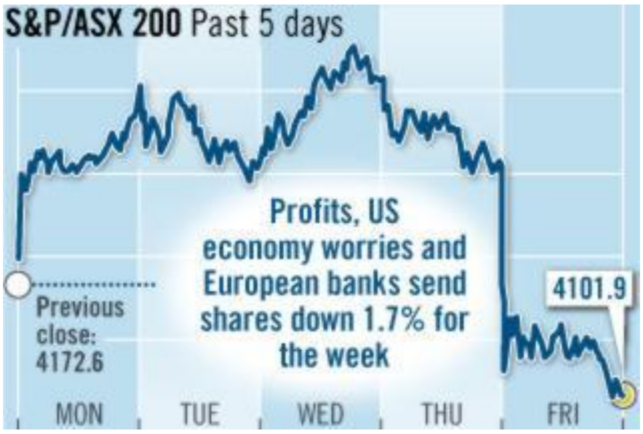
SWM FINANCE MATTERS

Investors have been sending our sharemarkets on rollercoaster rides lately – it's enough to give you nose bleed.



Many are of the opinion that they should have "cashed out" and placed all their money in cash or under the bed. After all CASH IS KING!

Most of you know that I err on the side of conservatism when I build your portfolios and that is reflected in the strategic asset allocations.

When the markets bounced by 9% your portfolios did bounce but not by anywhere near that amount (4%).

And for those in Pension phase most of you know I have factored in at least 3 years worth of pension payments tied up in cash (earning the Reserve Bank of Australia's cash rate) to enable us to ride out volatility.

These are trying times. You are not orphans to the market movements and the associated fear and panic that ensues.

BUT remember the longer term objectives that we set out to achieve are married to the strategic asset allocations within your portfolio.

The best defence to these markets are good strategies, a cool head and a sufficiently diversified portfolio.

The following article, **When Cash is King, written by Robin Bowerman of Vanguard Funds Management** reminds us that we should be looking through the noise towards our longer term objectives (our end goals) and not listening to the short term static that distorts our vision.

When cash is King

Risk can be found even in places of apparent security.

Cash is the undisputed king of the investment world *at the moment. That is hardly surprising given the Eurozone debt imbroglio – and a US political landscape that is hardly conducive to tough political decisions on reducing federal debt as we head into a presidential election year.*

A random survey of the financial planning community at the moment tells a consistent story – investors are pessimistic and opting for short-term security over long-term growth. Where is the risk in that? Well that depends on your age and circumstances.

Major banks at the moment are offering five-year term deposits around the 5.5-6 percent mark.

Given the past five years on the Australian sharemarket have returned about 2 percent as measured by the S&P/ASX 300 index, that does not seem like a bad deal – and effectively capital guaranteed as well.

But if you are not going to retire for another 20 or 30 years does it still make sense? Or if you are newly retired and are more concerned about capital protection is the argument even stronger?

Sharemarket data research group Andex recently prepared a risk/return analysis over 20-year periods dating back to the 1950s.

The median 20-year return produced by Australian shares from 1950 to 2010 was 12.9 percent using rolling month-end figures.

The worst 20-year period was the 20-years to the end of February 2009 when the Australian market returned 8.4 percent.

Now there is nothing to indicate that returns over the next 20 years may not be worse, but what that analysis of our sharemarket returns shows is that an ***investor opting for term deposits for their entire portfolio is taking a very pessimistic view about*** *the Australian sharemarket indeed – and by extension,* ***the entire Australian economy*** *and the major companies that dominate our sharemarket.*

In simple terms, the bet people moving completely into cash are taking, is that over the long-term the Australian sharemarket will produce a return well below the worst 20-year return seen over the past six decades.

Past performance is no indication of future returns but it does provide a historical context and framework, particularly where emotional influences are possibly pushing us towards the extreme end of an asset allocation decision.

This is not to say that a conservative asset allocation is incorrect, rather that things other than short-term market sentiment should determine your asset allocation. A recent retiree can argue powerfully that capital protection is the overriding driver of their portfolio today given the risk in the developed world economies.

But ***the average retiree has a life expectancy of 20 years****,* ***so they do still have the luxury of taking a long-term view****.*

The key point here is that it is not about taking extreme bets – either 100 percent in cash or 100 percent in the sharemarket – but rather the need to balance the portfolio's asset allocation based on factors like age and ability to withstand market shocks.

A long-term perspective *is a great ally in periods of extended market volatility, but it is even* ***more effective*** *when coupled with a* ***balanced, diversified approach****.*

If you have any questions please feel free to contact me.

Kindest regards,

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