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Written by: One of the many fund managers we use, Colonial First State, have kindly agreed to allow me to utilise this material.

With the start of a new financial year I think it is important to take stock and get back to the fundamentals of sound investing. The recent downturn has challenged all investors but gives us the opportunity to look back and test a few theories to see whether they do actually hold true.

7 Golden Rules of Investing

Investing successfully requires patience, clear goals, a long-term view and sound financial advice. When markets are volatile, it can be easy to forget these basics and make hasty decisions you may regret later.

This article aims to give you a better understanding of how sharemarkets work, help you put the recent market volatility into perspective and make sound decisions about your investments.

Rule 1 – Diversify your portfolio

Through diversification you can spread your investments so that they do not always move in the same way at the same time. This means that while one investment might be losing value, it could be counter-balanced by another that is gaining.

There are a number of different ways you can diversify your portfolio:

- ☞ **Asset classes** – the main asset classes are: cash, fixed interest property and shares.
- ☞ **Market Sector** – you could spread investments across different industries: resources, banking, industrial, agricultural, pharmaceuticals, leisure – various industries perform differently under the same conditions.
- ☞ **Fund managers** – different fund managers have different investment styles that can produce different results during various cycles of the market.
- ☞ **Geographic** – by investing in different countries around the world you can take advantage of the varying economic conditions.

Rule 2 – Appreciate the value of compounding

Albert Einstein supposedly once said compounding interest was “the most powerful force in the universe.” Compounding can be the investor’s best friend. Simply put, by reinvesting any returns in your investment you can then gain receive future returns on those returns as well. If you made a small contribution to your investment, this can have an even greater effect.

Rule 3 – Remember, markets move in cycles

In the 5 years to the end of 2007, the Australian sharemarket has experienced an unusually long period of sustained growth. This may have led some people to forget that markets move in cycles, they go down as well as up. All sorts of things can send jitters through world sharemarkets causing prices to fall from time to time. World

events do have an impact. However, over the long term, the general trend of sharemarkets has historically been upward. It is important to remember that after ever downturn, the market has always recovered. Some recoveries have been faster than others – but in every case a recovery has always followed a fall.

Rule 4 – The time in the market rule

This is a vital rule to understand if you are trying to “time” your entry into, or exit from an investment: **it’s time in the market, not timing the markets** that counts. By taking a long-term view of investing, investors can ride out any short-term fluctuations in the market and take advantage of the potential growth over the long term. If you invest in a fund with a seven year timeframe but you decide to sell your investment after three years because of disappointing results you could lose out on four years of potential growth.

Rule 5 – Understanding the implications of withdrawing

It’s common sense that before you make an investment you understand all the implications, risks and costs involved. Exactly the same is true when you withdraw from an investment. It’s vital to know what the implications and costs will be.

There are three major considerations which you should consider before you withdraw from a fund or other investment.

- ☞ **Crystallising losses** – selling as a knee-jerk response to market movements can create problems. If the value of your investment is falling, you are only making a loss on paper. A rise in price could soon return your investment into a profit without you doing anything. Selling your investment makes those losses real and irreversible.
- ☞ **Capital Gains tax** – Make sure you know what your Capital Gains Tax (CGT) position will be before selling any investment in a managed fund or shares. CGT is payable on any gains made on an investment. If the investment has been held for more than 12 months, a discount may apply to the capital gain.
- ☞ **Losing the benefits of compounding** – If you’re thinking about making a partial withdrawal from an investment, remember you will lose the effect of compounding on that withdrawal.

Rule 6 – Keep yourself informed

To be a sound investor you don’t have to be a stockbroking hotshot, but it pays to stay informed about your investments and keep up to date with the latest developments. There are a number of ways you can do this including monitoring your investments from time to time, spending time to read information sent to you by your fund manager or the companies you have invested in, and subscribe to electronic newsletters from reputable sources. Some of these are available free of charge.

Rule 7 – Get some financial advice

Trusting your financial well-being to tips from mates and handy hints on TV is a bit like going to your grandmother for medical advice. The best piece of advice you can get is often “get some professional advice”. There are many examples that show how good advice from a well-informed financial adviser can bring financial benefits that far outweigh the cost of the advice.

A voice of reason – When the sharemarket is going through periods of volatility your financial adviser can offer a calm professional voice that will cut through what you hear in the media and ensure you make informed decisions based on your needs, objectives and personal circumstances.

More than simply investing – A good financial adviser will help you decide what you want to achieve with your money, set financial and life goals and then put together a strategy for meeting them. A complete financial plan will cover a number of important areas:

- ☞ Retirement planning
- ☞ Investment planning
- ☞ Tax-effective investing
- ☞ Planning for business-owners
- ☞ Insurance
- ☞ Estate planning
- ☞ Centrelink benefits, and
- ☞ Cash management and budgeting.

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