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## **Volatility - Friend, Foe or Simply Misunderstood?**

One day the share market is up and the next it's down. Sometimes it's even up and down on the same day! We are currently seeing a lot of volatility in the share market. The big question is why?

There are a number of reasons why:

- Technology, for one, has advanced enormously. At the push of a button investors can now move money in and out of markets at an given time. These movements affect market values much faster than they used to in the past.
- Another reason is the increasing volume of money that is moving in and out of markets on a daily basis. This is largely due to the increasing number of baby-boomers, looking to maximise their investment returns and generally becoming more active in dealing with their retirement savings.

It's wise to note that not only the share markets experience volatility, in fact most investments do. That is why it's important to:

- Accept that volatility is a normal part of investing;
- Understand how best to benefit from volatility, rather than to be fearful of it.

## **Putting volatility into perspective**

It's hard to put volatility into perspective with headlines like "the market fell sharply today" and "XYZ stocks tumbled".

Sensational commentary like this tends to distract the investor from focussing on the big picture. Generally speaking, with quality investments, higher volatility leads to higher long-term returns.

## **Why is it that returns are so good when volatility is so high?**

Volatility is not only about falling values - it's actually about rising values too. So volatility is something you can look forward to if you have quality investments.

At times of market volatility we all need to be reminded that reaping the rewards of investing long term often requires enduring the risk of some short term discomfort - whether financial or psychological!

## **Steps to minimise the effects of volatility**

### **1. Diversify!**

If your portfolio contains only shares from one sector of the market - for example, only retail shares - you will be fully exposed to the full impact of the rise and fall of that sector of the share market.

By mixing your assets, i.e. building your portfolio being mindful of having exposure to other sectors of the market also or adding listed property, cash or fixed interest to your portfolio - you could be offsetting the poor performance of one asset, with the good performance of another. Obviously the converse is true also. This can limit the performance so you need to be clear what you are trying to achieve and what represents an acceptable level of return to enable you to achieve your goals.

## **2. Invest for the long term**

In the big picture, volatility has little or no impact on long term investment returns. Volatility is a short term problem.

According to Van Eyk research an investment in an index of Australian Shares from 1971 to December 2008 would have achieved a 14.09% compound return.

The worst year in the Australian share market would have produced a -44.40% return.  
The best year an 86.13% return.

## **3. Invest in quality assets**

Investments with reliable income streams and sound management are far less susceptible to volatility. When prices fall these types of assets usually tend to recover (and prosper) the fastest.

## **Investing regularly helps to take the volatility out of the market**

There's a popular piece of investment jargon that describes a way of taking the guesswork out of successful investment timing. It's called Dollar Cost Averaging.

In plain English, Dollar Cost Averaging means investing regularly, regardless of what the market is doing. It's a way of making the value of your investment grow at the same time as removing the difficulty of "timing the market". In the long run, investing on a regular basis also helps to reduce your overall risk.

### **It's hard to time markets**

Make no mistake, it's hard to time when to enter and exit markets. Financial markets are made up of a host of different investors. There are large institutions, such as fund managers, as well as companies, brokers and individual investors. Over the long term, markets can do well but in the short term, prices fluctuate on the basis of fundamental news, market sentiment, expectations, rumour and competitor activity.

Sometimes the "herd" mentality can set in. When the news about a particular stock is good, investors buy in. Even though the price keeps rising, buyers keep buying, as nobody is sure when the price has peaked. Similarly, when prices are falling, nervous investors sell in an attempt to cut their losses.

There are statistical measures and yardsticks, such as price-earnings ratios, which help determine the true value of a stock or bond, but as the boom and bust in Internet stocks has proven, rational measure are often ignored and sentiment can take over.

Deciding when to invest in this environment can be a stressful task. In the market is doing well you may fear that you're buying when prices are too high. By contrast, when the market is falling, there is a reluctance to invest due to fears that it may fall further.

So what should an investor do to avoid having to make these timing decisions? Invest regularly!

### **Why investing regularly works**

Investing on a regular basis removes the stress of "timing the market" because you are employing the concept of "Dollar Cost Averaging". This means that you buy more shares when prices are low and fewer shares when prices are high. The trick to all this is to remember that it's not the price you pay for each share that matters. It's the average price per share over time that determines your overall return.

The key is dollar cost averaging, which, in simple terms, just means investing regularly.

We help many people establish sensible regular investment programs that will help them achieve their goals. Do not put it off. The sooner you start the better off you will be!

**"It is time in the market, not timing of the market that counts".**

Working with a professional advisor will assist you to avoid the many pitfalls of investing. You don't want to be one of the many people you hear about who lost everything!

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