

# Invest Well

## Buy American Stocks.....I Am

Warren E. Buffett, Omaha, chief executive of Berkshire Hathaway, a diversified holding company.

From [www.nytimes.com](http://www.nytimes.com)

The financial world is a mess, both in the United States and abroad. Its problems, moreover, have been leaking into the general economy, and the leaks are now turning into a gusher. In the near term, unemployment will rise, business activity will falter and headlines will continue to be scary.

So ... I've been buying American stocks. This is my personal account I'm talking about, in which I previously owned nothing but United States government bonds. (This description leaves aside my Berkshire Hathaway holdings, which are all committed to philanthropy.) If prices keep looking attractive, my non-Berkshire net worth will soon be 100 percent in United States equities.

Why?

A simple rule dictates my buying: ***Be fearful when others are greedy, and be greedy when others are fearful.*** And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.

Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month - or a year - from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.

A little history here: during the Depression, the Dow hit its low, 41, on July 8, 1932. Economic conditions, though, kept deteriorating until Franklin D. Roosevelt took office

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in March 1933. By that time, the market had already advanced 30 percent. Or think back to the early days of World War II, when things were going badly for the United States in Europe and the Pacific. The market hit bottom in April 1942, well before Allied fortunes turned. Again, in the early 1980s, the time to buy stocks was when inflation raged and the economy was in the tank. In short, bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price.

Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to approximately 10,000. You might think it would have been impossible for an investor to lose money during a century marked by such an extraordinary gain. But some investors did. The hapless ones bought stocks only when they felt comfort in doing so and then proceeded to sell when the headlines made them queasy.

Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.

Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: "I skate to where the puck is going to be, not to where it has been."

I don't like to opine on the stock market, and again I emphasize that I have no idea what the market will do in the short term. Nevertheless, I'll follow the lead of a restaurant that opened in an empty bank building and then advertised: "Put your mouth where your money was." Today my money and my mouth both say equities. ❄

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***You don't need to be wealthy to invest.  
You need to Invest Well to be  
wealthy.***

# Surviving the bear

Robin Bowerman, Head of Retail at index fund manager Vanguard Investments Australia.

From October 2008 ASX Investor Update.

History is a useful guide for making sense of market downturns, writes Robin Bowerman of Vanguard Investments.

Investors must feel like they have been on the emotional rack for the past 12 months. The collapses in share and credit markets around the world have surprised, disappointed, challenged and - it has to be said - given a generation of investors a crash-course on risk.

Courtesy of the human evolutionary path, our brains are not well-wired to make rational, unemotional decisions. That makes this a potentially dangerous time because the compounding impact of poor returns and bad news may see investors effectively throw in the towel, sell out of growth markets and retreat to the safety of cash.

The study of behavioural finance provides a strong framework for understanding how we make decisions and, more importantly, suggests strategies to avoid making costly decisions prompted by short-term emotional bias.

Two key behavioural traits are overconfidence and loss aversion. Cast your mind back just 12 months ago and overconfidence - manifested in the assumption that markets would continue growing at similar rates - seems clear. Loss aversion studies tell us that losing a dollar feels 2.5 times worse than the pleasure we get from winning a dollar.

A key lesson from the behavioural finance research world is that the way questions or situations are framed can be a major influence on our decisions.

In investing terms, this is the different perspective you get if you focus solely on the one share in your portfolio that has dropped 20 or 30 per cent. Painful? Certainly, but consider it in the context of all the shares you own, then add your super fund's balance, the equity in your home and - if you want to really change the view - the value of the future income stream of your salary.

It is the ability to widen the frame as an investor that can help us take the short-term emotion out of market volatility. It is just over a year since the United States sub-prime mortgage market began to spectacularly unravel. The first question to be asked is how bad is it compared to other market downturns?

**Consider the history of the Australian sharemarket over the past 20 years.**

There have been seven occasions before this when the sharemarket has fallen more than 10 per cent. The average decline is 21.2 per cent and it has taken on average 15 months to recover the previous market highs.

While investors are told constantly that past performance is

no guarantee to future returns, these figures do help give us a useful context for what we are experiencing. The unmistakable message is that a decline like this is not out of the ordinary, though larger than average. It also says that \$10,000 invested back in June 1978 with all income reinvested along the way delivered 14.5 per cent a year to the end of June 2008 and would have grown in value to \$586,070.

By comparison, \$10,000 invested in cash over the same time period grew to \$162,376, which was a 9.7 per cent annual return. What that tells us is that the extra risk investors took - and when there were two declines of more than 30 per cent in the period - was ultimately rewarded.

But a real risk is that investors cannot handle the emotional rollercoaster that comes with this type of market volatility and that they sell out of markets at or near the bottom of the cycle.

The behavioural studies suggest that diversification is one straightforward strategy that helps investors "frame" their investments and keep the risk within acceptable bounds.

A dollar-cost-averaging approach, where money is invested at regular time intervals, is another way to take the emotion out of the timing decision.

Finally, a written financial plan that reminds us that the long-term goals that are the reasons for investing in the first place may just be the most useful tool an investor has when riding through periods of severe market turbulence. ❁

## FINANCIAL FACTS OF LIFE

**Almost one-third of Australians use the service of a financial planner . . .**

In total, almost 30% of Australians currently use the services of a financial planner. This increases with age from just 10% of those aged 16-24 years, 27% of those aged 25-34, 32% of those aged 35-49 and 37% of those aged 50+ years.

*Galaxy Research, prepared for the FPA, May 2008*

**. . . and as a result they're more likely to feel prepared for retirement**

84% of those who have seen a planner in the last 12 months say they are very or fairly confident that they will have enough money to retire comfortably. This compares to 57% among those who have not seen a planner at all.

*Nielsen Research,  
commissioned by ING Australia 2007.*

# Looking beyond the uncertainty

Riccardo Briganti, Head of Research at Macquarie Private Wealth.

From September 2008 Forward Thinking

## Uncertainty begets opportunity

During periods of extreme share market uncertainty, it can be easy to forget that the history of financial markets is punctuated by crises. In the midst of each of these it was as difficult to see the way out of the seemingly all-engulfing turmoil as it is now.

You need not look too far back in history to identify a number of such events. The US Savings and Loan crisis in the 1980s saw more than 700 savings and loan associations bankrupted. The Asian financial crisis in 1997 saw most Asian equity markets halve but had little impact on US and Australian markets. The Russian debt default and the subsequent collapse of Long Term Capital Management (LTCM) some 12 months later saw a significant decline in US equity prices but proved short-lived.

The Tech crash and the accompanying US recession in the early part of this decade provides a more extreme example of a crisis or bursting of a financial bubble.

None of these previous periods are directly comparable with the current environment but they provide a basis of comparison which can be useful in determining the possible path out of the current problems.

There are some major differences (the scope and reach of the problem, debt and gearing levels, the influence of hedge funds) which make the current environment more challenging than previous examples. Other differences (expansionary US monetary policy settings and the direct intervention by the US Federal Reserve and other US authorities) support a more positive reading of the current situation.

It is also useful to review how the Australian equities market has fared following significant declines. The table below shows periods of share declines in the All Ordinaries Index since 1970 and how the market subsequently performed. It confirms that exiting the equities market following a significant decline runs the risk of missing the subsequent upturn which in most cases is substantial.

## Positioning your portfolio

There is a temptation to completely reconfigure investment strategies in times of uncertainty. It is both appropriate and useful to reassess an investor's risk tolerance in light of changed market conditions and to focus on quality investments. However, it is also necessary to emphasise that the long-term risk/return characteristics of asset classes are very stable and incorporate the type of volatility currently being experienced in financial markets.

For example, the share decline in equity markets raises the question of the appropriate level of equity exposure in an investor's portfolio. However, if we look at the performance

of Australian equities over the last 70 years, the current decline is consistent with previous periods of sharp weaknesses – such volatility is part of the normal long-term risk/return profile for equities.

Over the last 12 months, the All Ordinaries Index has fallen by more than 40%. Declines of this extent were seen in the late 1980s, the early 1980s, and the mid 1970s. Less extreme declines are more common, with falls of around 10% occurring on a regular basis.

The nature of equities markets means that periods of strong returns are offset by periods of weak returns. Over the long-term, positive returns outweigh negative returns and the overall return to equities is above those of other asset classes.

## Australian share market declines and recoveries

	Decline over period	Return in subsequent 12 months
31/1/1973-30/9/1974	-58.2%	52.9%
31/5/1981-31/3/1982	-35.2%	10.9%
30/9/1987-29/02/1988	-44.4%	18.8%
31/8/1989-31/12/1990	-27.4%	29.0%
31/1/1994-31/1/1995	-20.5%	24.3%
31/3/2002-28/2/2003	-17.4%	21.4%
31/10/2007-current	-46.0%	?

Source: IRESS and Macquarie Private Wealth

## Getting out or missing out?

Furthermore, there is a danger with attempting to invest at the bottom of the market or, in other words, time the market. In the current environment, it is difficult to predict when the market will post a strong recovery. Historically, when the market does recover it tends to spike higher very quickly – as shown in the table above.

As an example, if an investor had invested \$100 10 years ago on 30 June 1998 and remained fully invested for the entire period, the \$100 investment would have grown to almost \$300 by the end of the period. An investor only needs to miss the 20 best days of Australian share market performance over the last 10 years to substantially diminish the wealth creation potential of investing in equities. Instead of \$100 growing to nearly \$300, it would have increased to \$160, foregoing the extra \$140 gain by missing the 20 best days.

If you are going to be invested in equities, which over the long term provides returns above other asset classes, your focus needs to be resolutely on the long-term benefits. Attempts at market timing are likely to do more harm than good. ❁

# Your mortgage for a better life

If you're over 60 and own (and live in) your own home, you may be able to borrow money against the equity in your home to use for whatever you like – home improvements, investment or even overseas holidays.

Borrowing money against equity in a home isn't a new concept but misconceptions about reverse mortgages, including the fear that they may lose their home title or pension benefits, is preventing many retirees from considering the reverse mortgage option.

According to the *It's on the House Sequel-RFI Reverse Mortgage Study\**, although nearly 80 per cent of Australians aged 60 and over have heard of reverse mortgages, as few as 40 per cent understand how a reverse mortgage works. Some 28 per cent of seniors surveyed believed that a reverse mortgage involves selling a portion of their house to a bank in exchange for money, or that they must make compulsory repayments until they die.

Some lenders do allow you to make repayments at any time without penalty, but generally you don't make any repayments on the loan until you leave and move into care, sell your home or die. All fees and interest are simply added to the loan balance each month.

Although the loan balance will increase over time, because you're only borrowing up to 40 per cent of the value of your home, you'll generally still have enough equity when the time comes to repay the loan.


There are a number of things you should consider before using your home to borrow money. Interest rates are variable so you won't know exactly how much you'll owe at the end of the loan or if the remaining equity will cover the

loan balance. The lender's terms may require you to maintain your home to a certain standard to avoid defaulting on the loan. You may not have enough money left over after paying the loan for aged care accommodation or to leave an inheritance.

It is important that you carefully consider all these factors. Talk to your financial adviser and your family first before taking out a reverse mortgage.

\* Study conducted by Senior Australians Equity Release Association of Lenders/Retail Finance Intelligence, October 2007 ❄

Source: *Investment Solutions – Winter 2008*



## CHRISTMAS/NEW YEAR BUSINESS HOURS

Our office will close from 12 noon. on Tuesday, 23<sup>rd</sup> December 2008 and re-open on Wednesday, 7<sup>th</sup> January 2009. If you need urgent advice or help during this time contact:

Frank Blundell 0414 533 017, or  
Michael Russell 0413 000 297, or  
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We hope you, your family and friends, have a wonderful break over Christmas and the New Year, and we look forward to continuing to give you every assistance to achieve and maintain your financial goals.

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