Colonial First State

7 handy rules
for investing

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

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

Rule 1: Diversify your portfolio

You can't control the markets but you can control where you invest. 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 counterbalanced 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 shares 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 the various cycles of the market.
- **Geographic** – by investing in different countries around the world you can take advantage of the varying economic conditions.

No need to pick winners

One of the advantages of diversifying your portfolio is that it can help take the guesswork out of which investments are going to perform well over different time periods and market conditions. With your investments spread across a number of different assets you don't need to pick winners. There's no reliable pattern of performance from one year to the next: past performance is not an indicator of future performance. Picking an asset simply because it performed well last year could lead to disappointing results next year.

Rule 2: Earn returns on your investment returns

Compounding can be an investor's best friend. Simply put, by leaving any returns in your investment you can then gain any potential returns on that as well. If you make small regular contributions to your investment, this can have an even greater effect.

Case study: Regular saving plan

Janet, Peter and Lynne all decided to invest $10,000 in the same fund for 10 years. Over that time the fund returned an average of 8% pa. Janet made no additional contributions. Peter added $100 a month and Lynne contributed an extra $200 per month. The difference in results is dramatic.

	Initial investment	Monthly contribution	Average annual return	Value after 10 years
Janet	$10,000	$0	8% pa	$21,589
Peter	$10,000	$100	8% pa	$39,602
Lynne	$10,000	$200	8% pa	$57,614

Dollar Cost Averaging

By investing regular amounts over time you can also take advantage of Dollar Cost Averaging. This is based on the one absolute certainty about sharemarkets: the price of shares go up and down.

With Dollar Cost Averaging you invest a set amount at regular intervals regardless of what the unit price of your fund is. In this way more money is invested when prices are low and less money is invested when prices are high. Over time this can even out the fluctuations of the market. It's one way of reducing your overall risk.

Rule 3: The long term trend is up

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.

The chart below shows how the Australian sharemarket has moved over the last 25 years. Importantly, after every downturn the market has always recovered. Some recoveries have been faster than others – it depends on a number of factors including economic circumstances – but in every case a recovery has always followed a fall.

Rule 4: Plan for the long term; don't react to the short term

Markets move in cycles; by moving in and out, you could miss out on a major gain. If you take a long-term view of investing, you 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 decided to sell your investment after three years because of disappointing results you could lose out on four years of potential growth.

Source: IRESS. S&P/ASX All Ordinaries Accumulation Index. Past performance is no indication of future performance.

Rule 5: React now and you might regret it later

It's common sense that before you make an investment you understand all the implications, risks and costs involved. Exactly the same is true before 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 prices could soon return your investment into 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. CGT is payable on any gains made on an investment and is payable when you sell that investment. If you've had an investment for less than 12 months it can be up to 46.5%. If someone is selling an investment because of a short term loss after a long period of sustained growth (such as between 2004 and 2007) then they could attract a significant CGT liability because of the long period of growth.

Losing the benefits of compounding

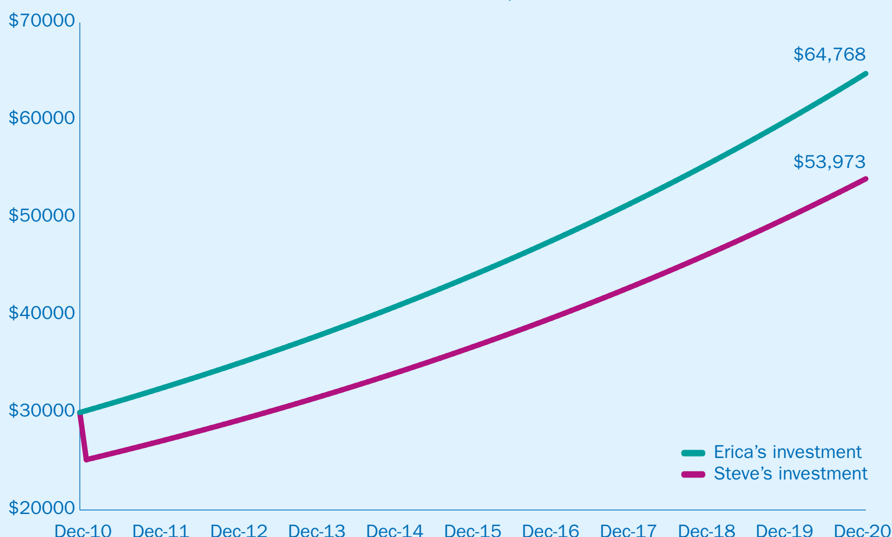
If you're thinking about making a partial withdrawal from a fund, remember you will lose the effects of compounding on that withdrawal. Take a look at this case study example where a $5,000 withdrawal results in a significant loss of earnings potential. It's not just the withdrawal you lose, but all the future earnings on that withdrawal.

Case study: Erica and Steve

Erica and Steve both invested $30,000 in a managed fund. Steve was going on an overseas trip and needed to pay for it so he withdrew **$5,000** from his investment. Steve enjoyed his holiday but lost the investment power of his $5,000.

As you can see from the graph, after 10 years, assuming an average return of 8% pa for both investments, Erica's investment has grown from $30,000 to $64,768 whereas Steve's $25,000 has only grown to $53,973, which is **$10,795** less than Erica. Of course, for shorter periods, say six to seven years, the difference is less but the message is clear – staying invested can have positive results for your investment.

The returns used are illustrative only and do not represent actual returns of funds offered by Colonial First State. Fund returns however generally fluctuate during the investment period.



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.

Market update

There's a market update section on our website to keep you regularly informed on what is happening in the market.

You can:

- find out the latest market news, and
- hear from our Investment Markets Reseach team via online webcasts.

Rule 7: Get some financial advice

Trusting your financial well-being to tips from mates and handy hints on the 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 help put together a strategy for meeting them. A complete financial plan will cover a number of important areas:

- retirement planning
- investment planning
- tax-effective investment
- planning for business owners
- insurance
- estate planning
- Centrelink benefits
- cash management and budgeting.

Want to know more?

Speak to your financial adviser and ask them any questions you have about investing. Your adviser is the expert who understands your needs best.

For more information on Colonial First State and your investments visit our website colonialfirststate.com.au or call us on 13 13 36.

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