TERRY CROSS FINANCIAL SERVICES PTY LTD

Investing today: Getting the right mix

Snapshot

Uncertainty about the future of financial markets has sent some investors rushing for cover, away from shares towards the relative safety and security of cash. It is a strategy which may make sense if you are focused on the present, but it's not a recipe for a comfortable retirement.

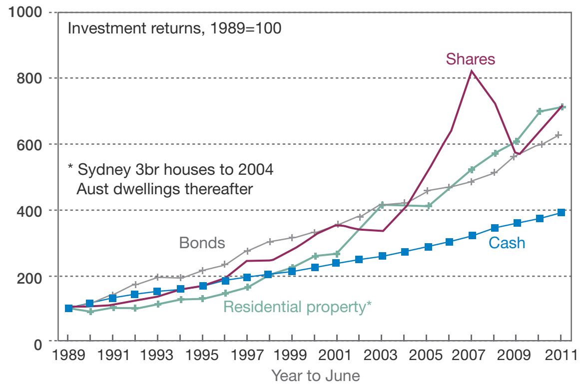
Successful investors assess the present and learn from the past but they have their sights firmly set on their future. To grow and preserve wealth over the long run you need to spread your money, and your risks, across a range of assets and asset classes.

On the face of it, the current market offers few places to hide. Australian shares fell 12 per cent in the year to 30 September, and almost 38 per cent since their peak in November 2007, while house prices fell in the year to August in all capital cities bar Sydney. Share prices may have risen sharply in October but who can blame investors for grabbing an interest rate of close to six per cent from a term deposit while they can get it?

Focus: total returns

When you compare the returns from different asset classes you need to look beyond the headline price rise or interest rate and focus instead on the total return from capital growth and from income in the form of dividends or interest. As the graph below shows, taking 1989 as the base, total returns from growth investments such as shares and property have easily outpaced cash.

The long-run view

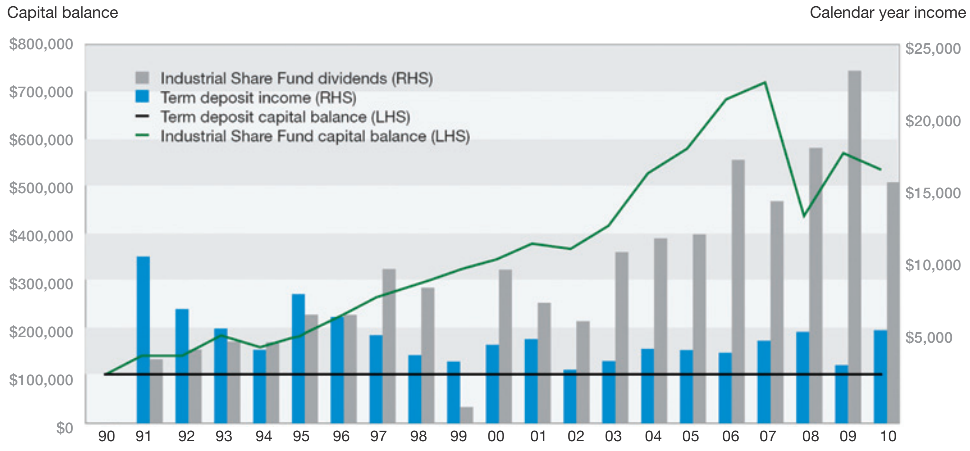


Source: CommSec, REIA, RP Data, Iress

The All Ordinaries Accumulation Index measures the total return from share prices and dividends. Over the past 20 years the Accumulation Index has risen on average around 10 per cent a year. If $100,000 had been invested in shares 20 years ago and the dividends reinvested, it would be worth more than $670,000 today while the same investment in cash would be worth less than $320,000.

Snapshot

$100,000 invested in an Industrial Share Fund vs Term Deposits (31 December 1990 to 2010)



Source: Perpetual Industrial Share Fund and Reserve Bank of Australia

However, these averaged returns over long periods gloss over some big short-term gains and losses.

As the Perpetual fund graph shows, annual returns from shares are more volatile than the returns from term deposits. But it also shows that while dividends and share prices both rise over time, $100,000 invested in a term deposit will only ever be worth $100,000 and income from interest will move up and down in line with interest rates.

Investors who stay the course and hold onto their shares are better off in the long run than those who have all their money in cash. But having your money in shares doesn't mean you tuck them away in the bottom drawer; like any investment they work best with regular reviews.

Covering your bases

Each asset class has its pros and cons, and each may deliver market-leading returns at different stages of the market cycle.

As a class, shares can be volatile and make some investors lose sleep, but they are easy to buy and sell and provide potential capital growth plus income.

Property also provides potential capital growth and regular income with less volatility than shares. However, a single property can take a big chunk of your funds and take a long time to sell, leaving you exposed to one dominant asset class.

You can't beat term deposits for safety and certainty, but they provide no opportunity for capital growth. This means the value of your investment will most likely fall in real terms, after taking inflation into account.

Retirees, people nearing retirement, or in fact anyone who relies on their investments for income, need to make sure they have enough money in cash and fixed interest, while also keeping exposure to growth assets to make sure their money lasts the distance. Younger investors can afford to hold a greater proportion of their savings in growth assets.

If you would like to discuss any aspect of your portfolio with us, please contact us so we can assist you to work out the most appropriate asset allocation for your current and future needs.

By spreading your investments across all major asset classes you can balance your need for regular income and a good night's sleep with your need to earn a return that will keep pace with inflation and provide for your retirement.

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