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Take Control - With Your Independent Financial Adviser

Autumn 2020

After an unprecedented summer of bushfires, we hope that Autumn brings cooler temperatures and soaking rain for all those who have been affected.

Data released in February give an early indication of how the Australian economy has been impacted by the bushfires and coronavirus, on top of the US-China trade war. The Reserve Bank of Australia lowered its near-term growth forecast for the year to June 2020 from 2.5% to 2.0%. New business investment fell 2.8% in the December quarter and 5.8% over 2019. Retail sales rose 0.5% in the normally super busy December quarter but were up just 0.3% over 2019, the slowest year on record. New vehicle sales were also sluggish, down 8.2% last year while the value of construction work done fell 7.4%. Consumers have perked up a bit since then, with the Westpac/Melbourne Institute consumer sentiment index up 2.3% in February.

Australian, US and European share markets all fell by more than 8% in February. Commodity prices also fell, although gold was up more than 5% due to its safe haven status. And the Aussie dollar dipped below US$66c, its lowest level since 2009.

Despite the economic challenges, the Australian corporate sector remains in good health. As the interim profit reporting season comes to an end, more than 90% of companies reported a first half profit (although a bare majority lifted profits), while record numbers issued dividends.

The low dollar, a rise in unemployment to 5.2% in January, annual wage growth stuck at 2.2% in the December quarter and sluggish economic growth make another cut in official interest rates more likely.

Rise Financial
25 Michell Street
Monash, ACT 2904
P 02 6292 0015
F 02 6292 0071
E phil@risefinancial.com.au
W www.risefinancial.com.au

Hold on... bumpy markets ahead

After period of optimism, global investment markets have hit the panic button on fears about the possible economic impact of the coronavirus (COVID-19).

At times like these, it's good to get some perspective.

Australian shares rose 24 per cent last year, touching record highs, and 10 per cent a year over the past seven years. Global shares rose 28 per cent last year and 17 per cent over the past seven years.[i] After such a good run, many observers have been saying shares were looking fully valued and that a correction was likely.

The thing with market corrections is that it is impossible to predict what will trigger them or how long and severe they will be.

Avoid knee-jerk reactions

At this point, markets are responding to uncertainty. Nobody knows what the extent of the economic fallout will be, so the temptation is to bail out of shares and put your cash in the bank. Or jump ship and switch to a 'safer', more conservative option in your superannuation fund.

While the urge to act and protect your savings is understandable, knee-jerk reactions can be a mistake.

It's near impossible to time the markets. Not only do you risk selling when prices are near rock-bottom, but you also risk sitting on the sidelines during as the market recovers. As history tells us it always does.

In an ever-changing world, the basics of investing stay the same. By sticking to some timeless rules it's much easier to avoid emotionally driven reactions and focus on your investment horizon.

Have a plan

Investing is a lifelong journey and like all journeys you are more likely to reach your destination if you plan your route. Without a plan, it's easy to be distracted by the latest market worries and short-term price fluctuations.

Think about your personal and financial goals and what you want to achieve in 1, 5, 10, 20 years' time. Be specific, put a dollar figure on your goals and plan how to reach them.

Low risk comes with lower returns

Many people are wary of investing in shares because of the perceived risks. Growth assets such as shares and property do entail higher risk than cash in the bank, but they also deliver higher returns in the long run.

Perhaps the biggest risk of all is not earning the returns you need to achieve your goals. While domestic and international shares produced stellar returns last year, cash returned just 1.5 per cent which was below the level inflation. Cash returns were not much better over the past seven years, averaging 2.2 per cent a year.

Spread your risk

Shares, property, bonds and cash all have good years and bad. While shares and property tend to provide the highest growth over time, there will be years when prices fall or go sideways. In some years, bonds and even cash produce the best returns.

A good way to reduce volatility and enjoy smoother returns over time is to diversify your investments across and within asset classes. That way, one bad investment or difficult year won't sink your ship.

The most appropriate mix will depend on your age, the timing of your goals and your risk tolerance. You will need cash for emergencies and short-term goals, with enough money in growth assets to last you through your retirement.

Let your savings grow

The effect of compound interest is often referred to as magic, but there's no trickery involved. Better still, it requires no work on your part, just the willpower to reinvest the income you earn on your investments, so you earn interest on your interest.

Rather than sell shares in quality companies in a panic, you could continue to collect your share dividends and reinvest them in more shares or other quality assets. This way, you avoid crystallising short-term paper losses and benefit from the inevitable market recovery.

That's the simple but powerful concept behind superannuation which locks away your savings and all investment earnings until you retire.

When fear is driving markets, it's important to get back to basics and think long term. If you would like to discuss your overall investment strategy, don't hesitate to get in touch.

i https://www.chantwest.com.au/resources/2019-a-standout-year-for-super-funds