Financial Focus

Winter 2020

In this issue

Adviser Details

Robert Gothard
Wealth Specialist - Certified Financial Planner®

Phone:
02 9501 1771

Email:
strive@strivewealth.com.au

Additional info:
Welcome to Winter 2020

Welcome to Financial Focus.

The coronavirus has upended the lives of most Australians, with many confronted by a challenging financial reality. In this edition of Financial Focus, we provide useful tips and information to help you make the best possible financial decisions. In all market conditions, including times like now, we encourage you to speak to your financial adviser.

Coronavirus investment opportunities – what to look for in share markets

While share markets have experienced some of the sharpest falls in history, amid the Coronavirus pandemic, savvy investors have been looking out for opportunities created by recent events.

Travel, tourism, retail and universities are among some of the hardest hit sectors in Australia, due to Coronavirus.[1] On the flip side, pharmaceuticals, video conferencing, entertainment streaming and e-commerce marketplaces have been coming out on top.[2]

So, if you're looking for investment opportunities for long-term returns, here are five principles that may help you get started. But keep in mind, share markets are unpredictable, even when things seem to be improving they can turn very quickly.

1. Keep a long-term perspective

When making changes to your investment portfolio, it's important to have a long-term view and plan to have your money invested for a while.

Just as we've seen a decline in share markets recently, history shows that markets recover. From the 1987 Stock Market Crash to the bursting of the Tech Bubble in 2000, each trigger is different and the time it takes to recover varies too. It could take months or even years.

As such, if you do decide to make changes to your investments during the current volatile markets, it's important to remember that the future is uncertain. Markets are constantly revaluing company prices with new information so this volatility is likely to remain until there's certainty around the containment of Coronavirus.

2. Do your research

There's a lot of 'noise' about the current state of the market, so keeping informed and getting an in-depth understanding about where you're investing, is key.

Here are just a few of the things you could consider when looking at listed companies in the share market:

- Does the company have a good track record?
- Where does it get its earnings from, domestically or internationally?
- How much debt does it have and when is it up for renewal?
- How are the company's earnings going to be affected by Coronavirus?
- Does the business have a strong competitive advantage?
- Does it have stable revenue and income?
- What are its risks in different economic environments?
- What price would you be prepared to pay for shares in the company?
- What are the risks specific to this company, its industry, and share market more generally?

If you decide to purchase shares in a company, consider monitoring it and any share market announcements, including financial updates or results, issues affecting the industry and any competitors.

You may also want to keep an eye out for any news coverage and interviews about the business to get a feel for their current and long-term viability.

And that's just the beginning. You need to consider how you'll reduce your exposure to the risks of investing in that company. Most people manage that risk by investing in many companies and asset classes because their performance is influenced by different factors.

3. Look for the red flags

It's important to distinguish between companies who have seen their share price fall as a result of market panic, caused by events like Coronavirus, and those that have fallen because they were already unstable and their weaknesses have been revealed by the economic downturn.

When identifying these undervalued shares, consider how much Coronavirus will impact the company now and in the future. It's also important to look at the company's balance sheet and business model to see if it can withstand this pandemic, or if it's prospects are substantially compromised by a further drop in share markets.

Other red flags to look out for include companies with a significant amount of debt or those that may be highly affected by economic conditions.

You may also want to check the company's position regarding ethical and sustainable investing and whether it aligns to your own values.

4. Consider contributing regularly

One of the ways to take advantage of a market downturn is to contribute a fixed amount to your investment portfolio on a regular basis.

The main benefit of this, as opposed to making a lump sum payment, is that it can help to reduce the impact of market volatility.

If you're contributing the same amount of money as you were when markets were performing well, then when markets fall, you're effectively purchasing at lower prices. For long-term investors, this is a great way of taking the guess work out of timing when to invest. Reality is, no one knows the best time to invest.

5. Seek support from professionals

Obtaining independent advice from your financial adviser, before making any decisions, can help you design a plan to achieve your own financial goals. It may also provide you with a better understanding about the risks and rewards of investing and appropriate investments for you.

Share markets are unpredictable so remember keep a long-term perspective. Given the complexities of investment decisions, it's important to stay informed and seek support from professionals.

[1]https://www.businessinsider.com.au/coroanvirus-australian-industries-businesses-affected-impact-2020-3

[2]https://theconversation.com/coronavirus-your-guide-to-winners-and-losers-in-the-business-world-134205

How different investment types play a role in market volatility

Understanding what the different types of investments are, and how they work, can help to explain why events like Coronavirus, may be impacting some peoples' investment portfolios and super more than others.

In this article, we'll break down what constitutes a growth versus defensive asset class and what the benefits are for each.

Asset classes perform differently

There are many different types of asset classes – shares and property, fixed income and cash are common ones.

Given how wide and varied they are, it's unlikely that a single asset class will meet all of an investor's needs. As such, an investment portfolio is likely to include a mixture of many.

As each asset class has its own characteristics, they perform differently at any point in time. So, when combined, they generate less volatility than simply investing in one, like shares.

Defensive versus growth asset classes

While asset classes differ, they also have some things in common. It's these commonalities that helps to categorise them as either growth or defensive asset classes.

Understanding how much of a portfolio is invested in one versus the other, can help determine the sort of volatility and returns an investor might expect. Other factors include investment goals, timeframe for investment and comfort with market volatility.

Growth asset classes explained

Growth asset classes have the potential to provide investors with higher returns, over the long term, by increasing the value of an original investment.

Investment returns are more likely to fluctuate over a short period however, due to changes in the market and other economic factors as we're seeing with Coronavirus. Common examples of growth assets are shares and property.

Shares

Shares are considered as a growth asset and aim to provide greater returns over a longer timeframe.

When invested in shares, an investor becomes a co-owner of the business – these could be household names like BHP, Telstra, and Amazon.

Returns from shares can be received in two ways:

- an increase in the company's share price which makes an original investment more valuable, and
- dividends which are an investor's share of the profits that the business makes.

On the flip side, share prices change daily so they present greater volatility and are considered higher risk.

Property

Property is also considered a growth asset as its value has the potential to grow over time and is one of few investment types that's tangible – something you can see, feel and touch.

Broadly, there are three main ways someone can invest in property.

Residential property

Purchase of residential property can be as an owner-occupier, or investor. While less volatile than shares, residential property values can change depending on demand in the market and supply of properties. Unless an investment in property is via an investment fund, there are high costs involved to buy and maintain it.

Real Estate Investment Trusts

Real Estate Investment Trusts (REITs), trade on share markets, in the same way as shares do, and give investors access to commercial property, such as offices, retail shopping centres, and industrial property for example.

REITs operate like managed funds with professional investment managers. They combine the money of many investors to purchase properties. Investors then earn distributions from REITs and can also benefit from long-term price increases.

Unlisted Property Trusts

Finally, there are Unlisted Property Trusts, which can also give access to properties through a trust, similarly to REITs. However, unlike REITs, these investment vehicles are not traded on stock exchanges. When buying into an Unlisted Property Trust, an investor essentially buys a 'unit' in a Trust that holds the properties and the Trust is managed by an investment manager.

The initial amount invested stays within the Unlisted Property Trust until individual assets are sold. The value of these units may go up and down and an investor may also have the right to receive income.

It's important to be aware that Unlisted Property Trusts are 'illiquid', which means that it can be difficult to get money out when you want to. During a market crisis this can be very difficult – many investors found their funds became 'frozen' in Unlisted Property Trusts during the 2008/09 Global Financial Crisis.

Defensive asset classes explained

Defensive asset classes aim to provide investors with regular income. This helps to keep their values stable which means they have relatively low volatility or risk.

The downside to this safety is that over the long term, defensive asset classes usually deliver lower returns than growth asset classes. In addition, those returns may not be enough to protect an investor from the rising cost of living.

Cash

Cash is regarded as a defensive asset class given it generally doesn't rise in value by much. It's also considered to be one of the safest asset classes as it's unlikely that an investor will lose money.

An investment in cash can be via a bank savings account or a short maturity term deposit, for example.

Fixed income

The best-known type of fixed income investments are bonds. They are considered part of the defensive asset cluster as they usually have lower risk than shares or property.

When investing in bonds you're essentially lending money to a government agency, if it's a government bond, or to a business in the case of corporate bonds.

With a bond, returns come in the form of the interest received from the loan. When there are changes in interest rates, the value of the bond changes too. For example, when interest rates rise, bonds with lower interest rates are less appealing to investors so their value tends to fall. On the flip side, when interest rates fall, their values tend to rise.

Having exposure to a combination of defensive and growth asset classes in an investment portfolio, may help balance out risk and return. This is important to keep in mind when during times of heightened market volatility – defensive assets can help to cushion falls from growth assets.

Why Coronavirus has more impact on some super investments

Understanding how super is invested may help to explain why events like Coronavirus impact account balances, if at all.

There are three main types of investment strategies which can be applied to super. Some of these strategies are focused on growing retirement savings by choosing investments that offer good growth potential over long periods of time. Others aim to generate a stable income by safeguarding investments from market volatility.

In this article we'll provide more detail about what the three main investment strategies are for super.

Risk tolerance

Before we address the three main investment strategies for super, it's always important to consider risk and market volatility.

An investor's risk tolerance depends on how they feel about taking risk and their ability to do so, such as whether an investor is financially able to wear the risk.

By understanding this, it can make decisions about the structure of an investment portfolio much easier.

Asset classes like shares and property, have higher return potential and experience greater fluctuations in value, than cash or fixed income investments. How much exposure an investor chooses to have in each of these asset classes may change depending on their level of comfort, especially during periods of investment market instability.

1. Growth investment strategy

A growth investment strategy is designed for investors with a long investment timeframe who feel comfortable with their investment balance fluctuating over short periods of time, in the pursuit of long-term potential growth.

As such, a growth investment portfolio is generally skewed towards growth investments such as shares and property (70-85%) with the remaining invested in defensive assets such as cash and fixed income.

Over a 20-year period, growth strategies have proven to deliver higher returns than more cautious or conservative portfolios which are aimed at generating a steady income and less volatility.

Given their higher potential returns, growth strategies are also more likely to ensure money outpaces inflation — this is important if an investor is planning to maintain their same level of spending in retirement.

2. Cautious investment strategy

A cautious investment strategy is designed to give a more balanced risk and return outcome by generating some level of growth, with less fluctuations than a growth strategy.

It would typically suit an investor who has a medium to long investment timeframe and would normally include a portfolio invested equally in growth and defensive asset classes.

3. Conservative investment strategy

A conservative investment strategy is not as focused on growth. Instead it aims to generate a steady income and more stable value by insulating investments from share market volatility.

It is important to note however, that while this is considered a more conservative approach, historically this strategy has only earned returns slightly better than inflation in the long run. As such, an investor with a conservative strategy may struggle to maintain their same current standard of living in retirement.

This approach could suit an investor who has sufficient retirement savings and is looking to access their super within a few years. They may therefore desire security as opposed to growth.

Due to the low level of risk, a conservative investment portfolio would have only 20-30% exposure to growth assets with approximately 70-80% invested in defensive assets.

Seek support from a professional

Working with your financial adviser can help design a plan to achieve personal financial goals. They may also provide a better understanding about the risks and rewards of investing and how to better manage risk.