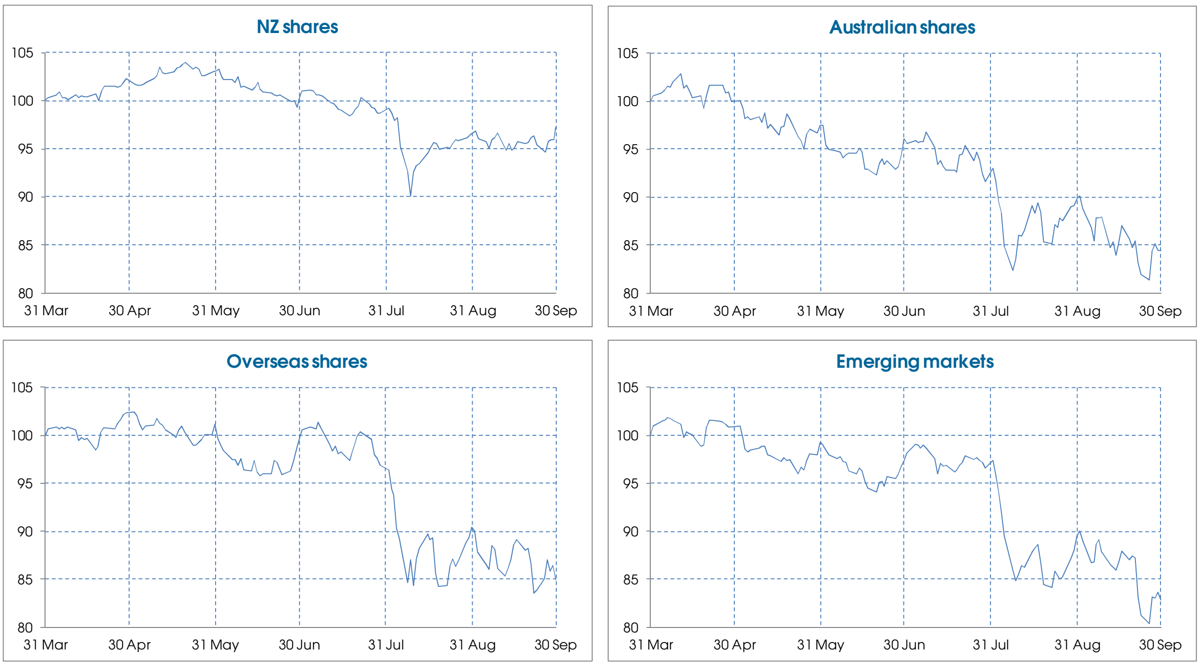
The market went down

As the events have unfolded in the investment markets over the last 6 months, it is easy to question why you continue to invest in shares. Returns from shares have been negative. NZ shares were less negative than overseas shares, which were better than Australian shares, which were better than emerging markets, but they were all negative.

Chart 1 — Share market returns (local currency) 6 months to 30 September 2011



But 6 months is a short period in the context of share markets and the last 6 months has been poor but not as bad as some previous 6 month periods.

Table 1

	6 months to 30 September 2011	"Typical" 6 months in the last 20 years	Worst 6 months in the last 20 years
NZ shares	-2.0%	3.8	-28.4
Australian shares	-15.6%	5.0	-31.6
Overseas shares	-15.1%	3.8	-39.9
Emerging markets	-17.1%	11.4	-46.7

Note, the 20 year period is the 20 years from 1 October 1991 to 30 September 2011. It therefore includes both the "tech bubble" of 2000 to 2003 and the current downturn.

In times like this, some investors reflect on their tolerance for the volatility of shares. As a result, they contemplate a switch to cash, or cash and bonds. While such a change reduces the future volatility, it is also likely to reduce the future long-term return. This is because interest rates are currently low, as seen in Table 2 and there is not the same protection against inflation.

Table 2 - Current interest rates

NZ cash rate	2.50%
NZ 10 year government bond yield	4.41%
US 10 year government bond yield	1.92%
Japan 10 year government bond yield	1.03%

Shifting to cash or bonds in the current environment reduces the volatility but locks in the loss from the last six months and makes the expected future return positive, but low.

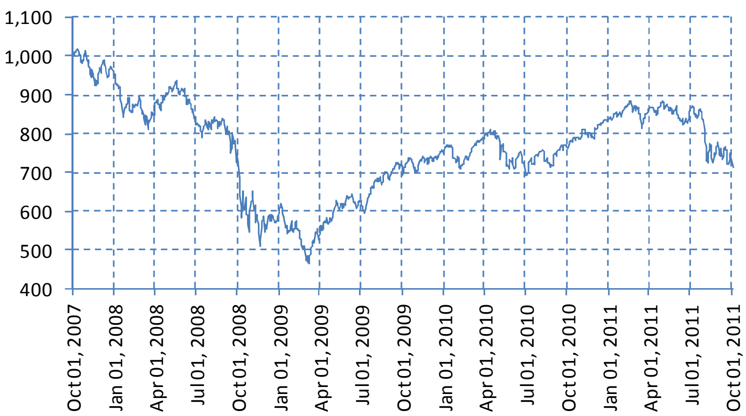
Will the share markets stop falling?

With shares, it must be remembered:

- Market down-turns have happened before and happen on a regular basis. It should not be a problem provided the proportions of the shares in the portfolio, were not bought with the intention of spending the money in the next few years.
- In the past when fall have happened, the share market has ultimately recovered, but the recovery can take several years. It is a test of an investor's patience and willingness to take on volatility.

Chart 2 plots the movement of the global share markets since the start of the subprime debacle in 2007 and the resulting global financial crisis. The last 6 months must be looked at in the context of the last 4 years.

Chart 2 - Overseas shares (gross, local currency)



In simple terms, since October 2007, global share markets are still down 28% but up 54% from the low in March 2009. This is a significant fall over a prolonged period and naturally creates a high level of uncertainty and concern. It is not known when the markets will stop falling, or return to the high of October 2007.

What would I do?

If I was looking to retire within 10 years and I had 60% of my money in shares today	If I was not planning to retire for 10+ years, and I had 60% of my money in shares
Given that the share markets have recently declined, my starting point would be to leave my current money invested as it is, and wait for the share markets to recover. I would not immediately realise the loss. I would allocate my future savings to cash (or cash and bonds) if retirement was 5 years off. My goal would be to build up my cash and bonds to cover my retirement expenditure needs in the first 10 years of my retirement and therefore give the current shares plenty of time to recover, before I realised them. I would also monitor the markets and review my strategy in 12 months. If the global situation has not shown signs of improvement, I might then start to realise some of the shares.	Given that the share markets have declined, my starting point would be to continue to invest in accordance with my current strategy. My new money will buy more shares today than it did 6 months ago and therefore boost my future average return. I see no reason to change strategy because of recent events. This assumes that when I set my original long-term strategy, my long-term strategy was right. At the same time, I would review whether having 60% in shares and the volatility that goes with this, was right for me. I am confident that the recent market down turn is not a one-off and will happen again. If it makes me feel too uncomfortable, I would change my future strategy to reduce my exposure to shares overtime.