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Investing in an uncertain world

29th September 2018

Invest for the long haul. Don't get too greedy and don't get too scared.
Shelby M C Davis

The best way to measure your investment success is not by beating the market but by whether you've put in place a financial plan and a behavioural discipline are likely to get you where you want to go.
Benjamin Graham

The function of economic forecasting is to make astrology look respectable.
John Kenneth Galbraith

Operator, give me the number for 911
Homer Simpson

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In talking with clients there is a certain degree of financial concern at the moment. A feeling which is entirely justified. Whether it's Trump inspired trade wars, falling residential property prices, rising interest rates, yet ANOTHER Prime Minister or lofty market valuations, there is plenty to be concerned about.

When I wrote **"Is it Time?"** in February earlier this year. I discussed the market volatility and asked if it was the beginning of the correction. It wasn't, at least not yet, but I also suggested we needed to put things in perspective.

Despite the list of concerns should we start selling? My answer at the start of the year, as it is now, remains a resounding NO. The results over the last year are detailed in the table below (this is a price table only, it excludes income):

Index	Price	Price	Change
	(Last Year)	(Now)	(%)
ASX200	5,671	6,175	8.89%
S&P500	2,497	2,919	16.90%
AUD/USD	0.7943	0.7282	-8.32%
OIL	$63.02	$72.08	14.30%
Sydney Residential Property	182.97	170.63	-7.13%
US Bonds (10yr)*	2.8	3.09	-2.90%

Note: * When bond yields rise their price actually falls.

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There are several points to note from the table on the previous page:

1. As usual, different markets move in different directions, all the time!
2. Some of the moves are quite substantial in just 12 months
3. Volatility has risen substantially compared to this time last year, evident in the 12 month chart of the Dow Jones Industrial Average below.

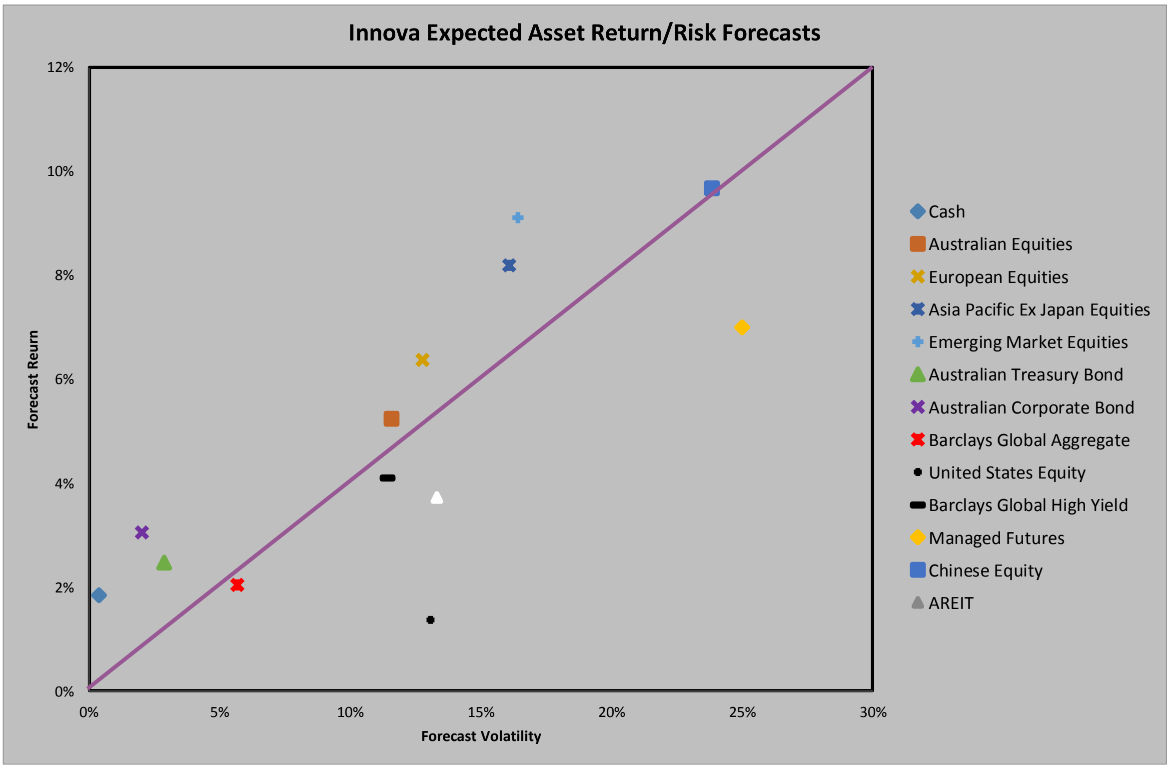
If we think to the concerns back in February, North Korea would have been top of mind, ongoing debt concerns, Chinese economy etc. The list has changed completely however the worries remain.

Domestically, Australia is in a precarious position right now. This is mostly related to the level of household debt and the amount of interest only debt that is due for refinancing between now and 2020. The market might get a little ugly for residential property.

If US interest rates continue to rise it will be exacerbated because we will likely see further mortgage interest rate rises here. These rises would not be driven by the RBA, it will be banks passing on the increased funding costs of interest rates rising overseas (where they source a large amount of their debt!).

We will be 'saved' if Trump triggers a full on trade war prompting a rapid downward correction in US interest rates. This 'cure' will be worse than falling residential prices which will probably fall anyway in a full blown trade war.

Globally, equities are expensive, most notably US equities. The chart below was produced by Innova Asset Management and shows US equites (small black circle) offering high equity volatility and very low expected return, the equivalent of cash returns (blue diamond), This looks like a bad investment at current prices.



We at Lifestyle Wealth Partners have rotated away from US equities and increased European and Asian exposures. They have similar forecast volatility in the chart above (orange cross for Europe and blue cross for Asia ex Japan) however substantially higher expected returns.

Further we have managed a strong rotation away from growth style managers into value orientated managers. Value managers are likely to provide a better buttress against downside volatility and less expensive markets. For example Europe and Asia will likely fair better as their valuations do not appear as stretched as the United States.

Interest rates globally remain extremely low, lower than here! This currently does not offer a good alternative so we are holding more domestically. Our over weight cash position has continued to hold us back (instead of fixed interest) a little however this too is a defensive measure.

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No-one can predict markets but not losing money is the simplest and most effective starting point for sound portfolio management. Further this cash can be used when asset markets are cheap, i.e. simply buying low which you can't do if you don't have surplus cash, another sound portfolio management technique.

So What Next?

Frankly no-one knows. We have been adjusting the seat belts in everyone's portfolio and are attempting to remain invested but doing so as cautiously as possible. It is important that we remain invested however in doing so we are taking precautions, protecting capital as best as we are able. Hiding in cash and fixed interest could be damaging and is poor investment discipline. Timing markets has proven to not provide any robustness or rigour that has stood the test of time.

Markets will always be unpredictable, they always have and they always will. They do however provide the best long term solution for investors and retirees. Perhaps just a little less media attention to stock prices and geo politics and everyone would feel a little better about things?

If you would like to discuss this paper or any other matter, please do not hesitate to contact us at support@lifestylewealth.com.au or (02) 9984 7774.

Kind Regards

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