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THE LONG AND WINDING ROAD

Up, Up and Away!!!

By Alan Dick CFP

If you follow my advice and ignore the financial pages of the papers and the stock market news on TV you may be blissfully unaware that investment markets are doing really well at the moment. If you don't follow my advice and find yourself drawn to the dark side of the media's financial porn – shame on you.

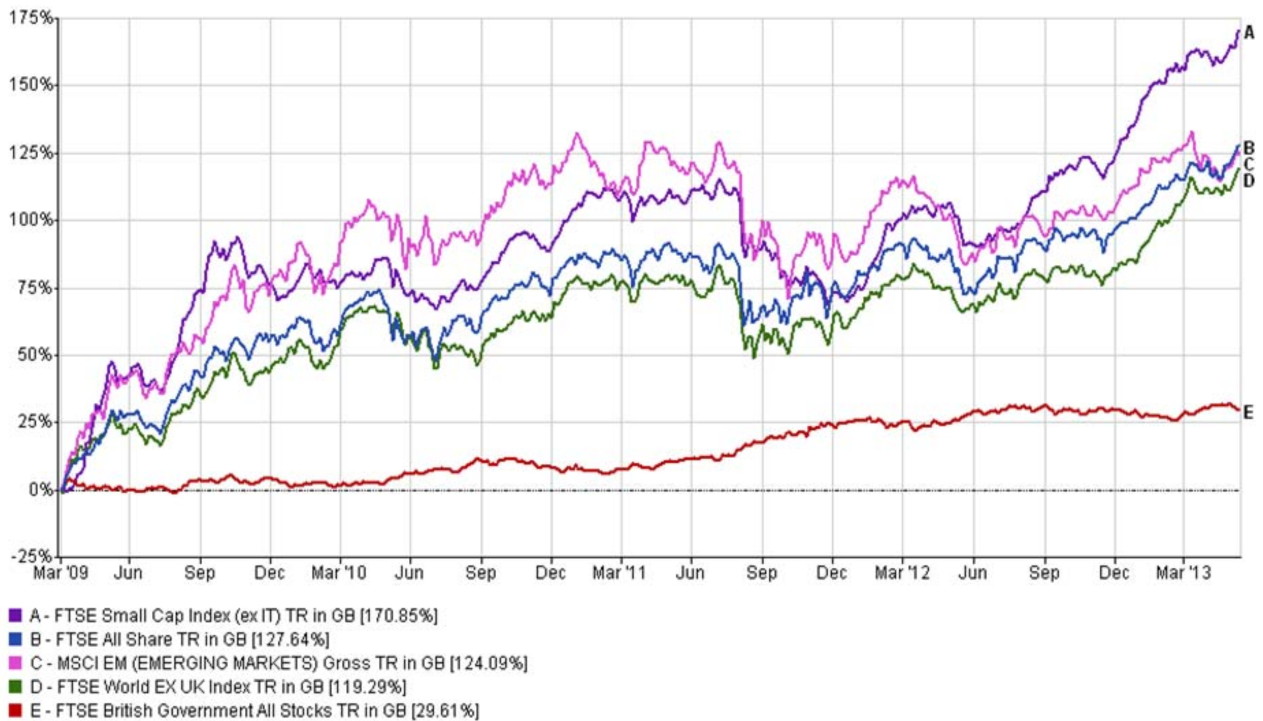
Many people are starting to get carried away with the wave of euphoria surrounding recent market gains. This can lead to some very poor investment decisions. One client actually contacted us today requesting we hold-off selling some legacy stock market investments until next month due to their recent impressive performance; which he thinks will continue until the end of June. He is in danger of committing one of our cardinal sins of investing - don't ever try to predict the future!

Let's take a quick look at some recent investment history to refresh our memory and remind ourselves how quickly we can forget the pain of the past.

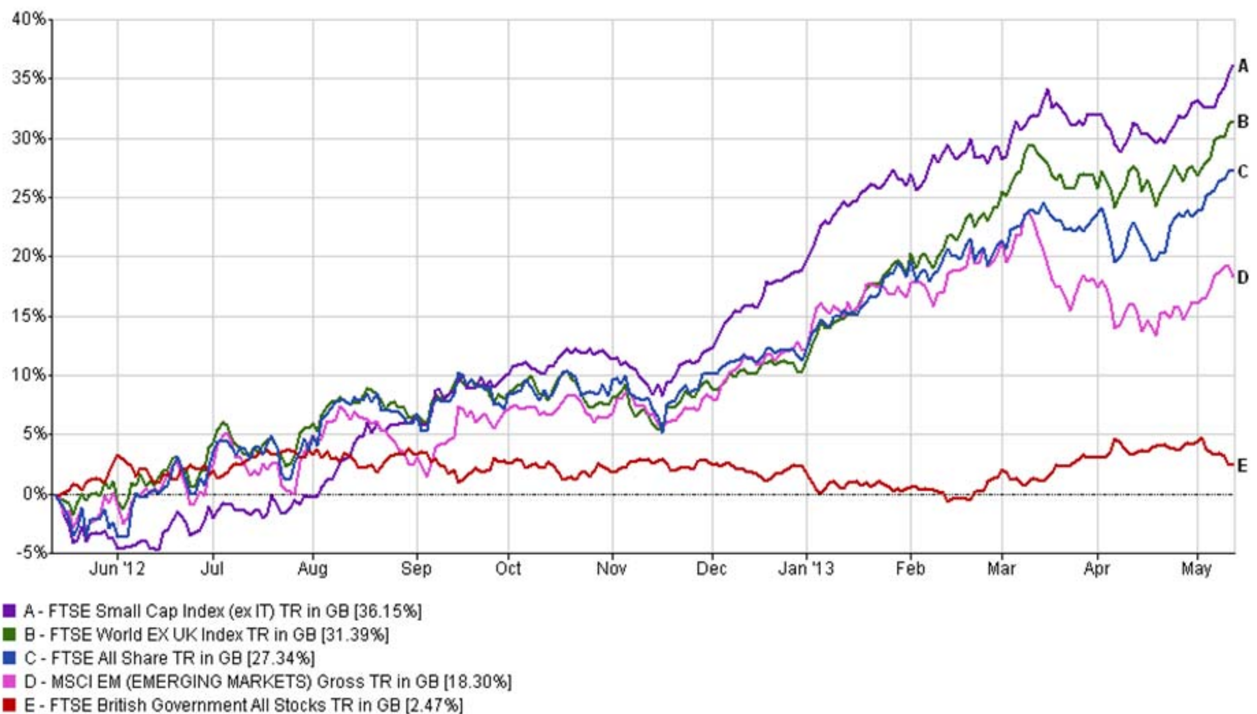
The peak of the Technology Boom occurred around the 4th of September 2000. Some investors will never forget the emotional pain of the following three years even though investments have since recovered and posted healthy gains. The FTSE All Share Index (including dividends) is actually 63% higher than its peak in September 2000. Emerging Markets are up over 200% and even the relative safe haven of UK Government bonds have doubled in value.

As investors forgot the Technology boom and bust, markets recovered fuelled by easy credit and a surge in property prices; this could be termed the Credit Boom. The FTSE All Share peaked on 12th October 2007 before giving way to the Credit Crunch. The following year and a half resulted in the near collapse of the global banking system with the bankruptcy of Lehman Brothers and Bear Sterns before governments eventually started to bailout banks with taxpayers' money. However, the UK market including dividends is currently 24% higher than the credit boom peak and overseas stock markets returned close to double the UK during this period. Other investments show similar trends though, importantly, not always at the same time. As you can see from the graph below, simply being invested in Government Bonds during that period would have given a higher return (and far fewer sleepless nights).

The fallout from the credit crunch hit rock bottom for the FTSE All Share on 3rd of March 2009. Since then the UK stock market has risen by 128% and UK Smaller Companies posted an even more impressive return of 170%.



In 2011 and 2012 investors suffered from the downgrading of America's credit rating and the Euro Zone crisis but the last 12 months have returned an impressive 27% for the UK stock market.



Looking at the graph above it is easy to see why investors might again be starting to believe that stock markets can do no wrong. This is a misconception that we all need to be particularly careful of. Remember that our approach to investing is based on long term discipline and the knowledge that none of us can foresee the future.

Here are three things that investors should remember while they are enjoying a rising market – and what to do about each one.

1 – Maintain the right balance of investments

We spend a great deal of time and effort at the start of our investment process, and at each subsequent review, ensuring that every investor's portfolio is designed to meet their personal needs. One of most important investment decisions any of us can make is the spread of investments between different assets such as cash, bonds, shares and property. It is important to ensure a wide spread of different investments and avoid the temptation to concentrate on recent top performers or investments with an emotional attachment. Basically don't put all your eggs in one basket!

Because different investments perform well at different times the portfolio proportions will naturally drift over time. It is important to ensure that you regularly rebalance to the original strategy. This discipline ensures that you sell assets that have performed well (effectively locking in gains) and top up assets that have lagged. This often seems counter-intuitive but it helps keep the investment portfolio on track to achieve your long term goals. It also avoids the portfolio becoming gradually more risky over time.

2 – Avoid getting swept along with the market

As I pointed out at the beginning of this article, it is easy to forget the pain of falling investment markets in the midst of a year-long unbroken rally like we are seeing at the moment. However, it is at times like these we need to be especially vigilant of our tendency to invest with our heart instead of our heads. Investments should be a means of achieving your personal goals and objectives not a form of excitement. If you want the excitement of gambling your money, go to the races or the casino.

Chopping and changing our investment strategy in response to recent market conditions often seriously detracts from returns rather than enhances them. Our investment philosophy is built on a rigorous process and deep rooted investment philosophy that stands up to the vagaries of investment cycles.

3 – Every penny's a prisoner

We all tend to pay more attention to expenses when money is tight. In the same way, we often focus on investment charges when markets are performing badly but throw caution to the wind when they are booming. At times like this, many people seem to forget about fees and are sucked into hot funds with excessive charges which are supposedly worth it because of manager X's incredible and unique ability. None of us can control the future of markets or the performance of individual managers but we can control expenses. A pound saved in fund management fees is a pound added to your portfolio returns. And it is a much easier pound to add than trying to add value by chasing market beating investment returns. That is why we are so obsessive about controlling portfolio management fees in all markets.

On any given day markets are just as likely to rise as fall and no one can predict the future. However, over the longer term markets work and well-constructed investment portfolios provide investors with healthy returns. The biggest single defence investors have against the unpredictability of markets is diversification. All of our client portfolios are carefully constructed and well diversified.

It is at times like this we can really show our value and help existing and new clients avoid costly investment mistakes. We often say we are in the invest**or** management business not the invest**ment** management business. The key to successful investing is simply to remain disciplined; to stick to the plan; and keep your head when everyone else is losing theirs. This simple philosophy works just as well when markets are rising as when they are falling.

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