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Seven steps to help get the right split

Many investors are understandably concerned when they read news stories about fluctuating global markets, European debt problems and national political decisions such as the carbon tax. How will this uncertainty affect the hard earned money you have invested, especially if you are nearing retirement?

A well designed investment portfolio will not only help you reach your financial goals, it can also provide some reassurance during times of uncertainty. A healthy mix of investments in different market sectors and asset classes can help you achieve smoother, more consistent returns over time.

How do you choose a diversified portfolio to suit you? Here are seven simple steps to consider.

1. Look to the future

For most of us, the future after retirement involves more opportunities to do the things we love, whether that's travel, golf, gardening or just more time with the grandchildren.

To turn dreams into reality, the first step is to understand just how much you'll need to fund your retirement lifestyle. There are many online calculators available that can provide a snapshot to show you how much you'll need (visit www.thewealthgeneration.com.au to see an example). As a guide, you'll need enough to live comfortably for 20 or 30 years after retirement.

Once you've decided on a goal – for example, the amount you'd like to have saved or invested when you hang up your gloves, and how many years you have left to achieve it – it's time to work with your financial adviser to identify the investment opportunities that will suit you best.

2. Know the asset classes

Trying to understand the plethora of investment options available can be confusing, but breaking them into different categories (or classes) can help make your decisions easier.

For example, many investments fall into one of four major asset classes: cash, fixed interest, property and shares.

Cash includes money in bank accounts and other investments such as bank bills, while **fixed interest** investments include term deposits, debentures and government bonds.

Cash and fixed interest investments are usually seen as steady performers that help balance the ups and downs of other higher risk investments. And, in the case of cash, there's usually fast and easy access to your money. Cash and fixed interest investments are best suited to shorter term investing.

Shares represent part ownership of a company. They can be bought and sold directly on the Australian Securities Exchange or you can invest in an investment vehicle such as a managed fund that invests in shares. You can earn income from your shares if the company chooses to distribute its profits by paying investors dividends and there's the opportunity for an increase in the value of your original investment if the company's performance improves.

Like shares, you can invest in **property** either directly (where you buy real estate), or indirectly (where you buy units in a property trust that invests in real estate).

Both property and shares are generally considered longer term investments. It can take longer to sell them to liquidate your investment (especially in the case of direct property) and their values tend to fluctuate more than cash and fixed interest investments.

3. Be aware of different risk levels

Cash and fixed interest are usually considered 'defensive' investments. That means they are lower risk, their returns are less volatile and they provide a regular income. Think of a bank term deposit – it provides a guaranteed return and at the end of the term, the amount you originally invested (your capital) is yours again.

In the medium to longer term, defensive investments tend to have lower returns or income and no growth in capital.

On the other hand, property and shares are considered 'growth' investments because, not only is there the potential for greater income to be earned, there is the potential for the capital value to increase over the longer term. Growth investment returns are typically more volatile over the shorter term.

With defensive investments you have access to your funds, whereas growth investments are suited to investors who have more than five years before retirement.

4. Understand the trade off between risk and return

When deciding which investments may be right for you, it is important to understand the trade off between risk and return and how to manage investment risk.

Low risk asset classes can limit the returns that you could potentially achieve, whereas high risk asset classes risk short term losses. As a general rule, the larger the potential investment return, the higher the investment risk and the longer you need to remain invested to reduce that risk.

So given each asset class will have its good and bad times, a diversified portfolio (including both low risk and high risk asset classes) may never achieve the top return in any given year and may never receive the lowest either.

You should be realistic with your investment choices. Don't select high risk investment options, if you are not prepared to also accept the potential losses.

5. Remember that markets move in cycles

Taking a look at the bigger picture – the performance of the Australian economy and movements in markets both here and overseas – is another way of helping to make sure your portfolio is structured to help meet your goals.

Markets and economies always move in cycles. They rise until they peak then begin to fall until they bottom out before rising again, and so on. Some choose to sell their investments as markets begin to fall believing they can choose the right time to buy back into the market as it rises again.

But getting it wrong comes at a cost. Looking at the table, if you weren't invested in Australian shares for the 10 best performing days over the 10 years to 31 December 2010, your average annual return would have more than halved from 8.66% to 3.87%.

Australian Shares performance for 10 years % pa

Ten year return	8.66% pa
Ten years less 5 best days	6.02% pa
Ten years less 10 best days	3.87% pa
Ten years less 20 best days	0.20% pa
Ten years less 30 best days	-2.75% pa

Source: IRESS, Colonial First State. All Ordinaries Accumulation index used. Returns as at 31 December 2010, expressed in per annum terms. Past performance is no indication of future performance.

6. Look at your existing portfolio

With your retirement goals in mind, a review of your current investments with your financial adviser is the next step. It's a good idea to discuss the proportion of each asset class in your portfolio to see if it has the trade off between risk and return that suits you best.

You can also diversify within asset classes to spread your risk even further. For example, by owning shares directly in a number of different companies and industries, or by investing in a managed fund that invests in a range of companies and industries.

7. Implement changes in consultation with your financial adviser

Even if you already have a financial plan, it's wise to review it with your financial adviser at least once a year. This will ensure your investment strategies remain appropriate to your current needs and that you are on track to meet your goals. Even slight adjustments in your investment portfolio may make a big difference to the outcome over the long term.

Speak to us if you would like to understand more about how a well structured investment portfolio may improve your financial situation.

Important information

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