

Issue 21 – Feb 2008

## IS IT REALLY THAT BAD?

The sub-prime related woes in the US continue to take its toll on the world markets with a global downturn now very evident. We will all be affected in one way or another. Some will lose out others will emerge winners. As self-directed investors we are not answerable to a boss, so we have the luxury of going easy on ourselves when times get a bit tough. We will no doubt hear people confidently explaining that “it’s only a loss on paper” and the like. But to some, there will be real losses as a number of people will “sell low” and give back some of the good long profits from the last few years – all due to fear.



### The Recent Past

- 2002 – 2006                      4 years of double digit returns on Super and Managed Funds as a result of the increase in the prices of quality shares.
- Mar-07                              China Syndrome - Shanghai market falls by 8.8%. As a result, the Australian stockmarket experiences it's biggest one day fall in almost 5 1/2 years.
- Aug-07                              Sub-prime crisis in the US causes another fall in the share market.
- Jan-08                              Fears of a US recession and the likely flow-on effect on global economic growth have panicked markets from London to China.

### Should we panic?

Here is an extract from an article published in the October 2007 ASX Investor Update email newsletter and is a timely reminder for those investors in the share market or managed funds.

*It is very rare for a correction to signal the start of a bear market. Looking over the last decade of market history, the market has nearly always reached a fresh all time high within three to five months of a pull back. Of the ten market corrections we've seen since 1996, the market has traded to a fresh all time high nine times, and the high is often reached within just five months.-*

Five months Date	% Fall	New all time high within five months?
1996 May	10%	Yes
1997 September	20%	Yes
1998 April	17%	Yes
1999 April	10%	Yes
2000 March	12%	Yes
2001 June	17%	Yes
2002 March	22%	No
2006 May	12%	Yes
2007 February	7%	Yes

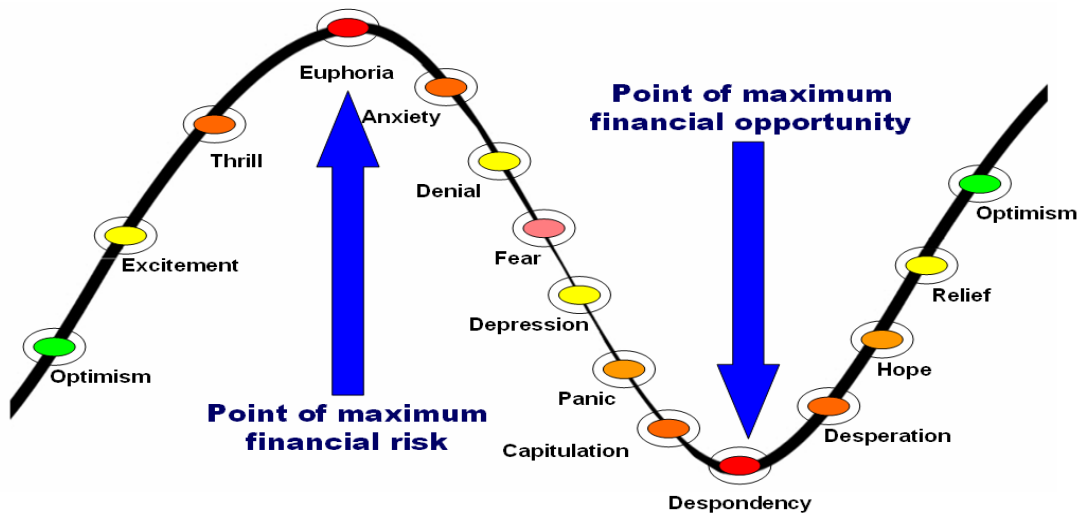
**The market has made a fresh all time high within just five months in nine of the last ten market corrections**

Economic changes bring upward and downward trends in markets but specific events such as wars , September 11 and this most recent US Mortgage panic, cause quick fluctuations that have proven over time, to go back to and above the previous value before the panic as confirmed by the above data.

Yet there are those that will opt out of the current market i.e. sell LOW and will then – in the near future when the markets look more promising – buy HIGH.

This has never been and never will be a smart investment strategy. So why do we behave in this way. Two words describe this behaviour. When the markets fall, FEAR pushes the investor to SELL. When the markets rise yet again, GREED pushes the investor to BUY. In other words, investor emotions play an important part in wealth creation.

## The Roller Coaster of Investor Emotions



### What happens during the periods of volatility?

As demonstrated by the above diagram, when the markets drop, it provides a window of opportunity to the smart investors. They buy and increase their long term holdings in quality shares or managed funds. This can be referred to as “discount buying” and presents these opportunities because of volatility.

Volatility is a fact of life and is a natural market occurrence that is driven by fear and greed. Understanding and accepting the truth of “trend” (see graph below), allows the knowledgeable investor to take advantage of volatility and increase profits.

This volatility is the essence of being in the market for the long haul and not adopting a “trading mentality “ by taking small profits or cutting so called losses at times when the media is creating panic. Long term investors do hold for the long term and these volatile fluctuations in prices do not affect their portfolios.

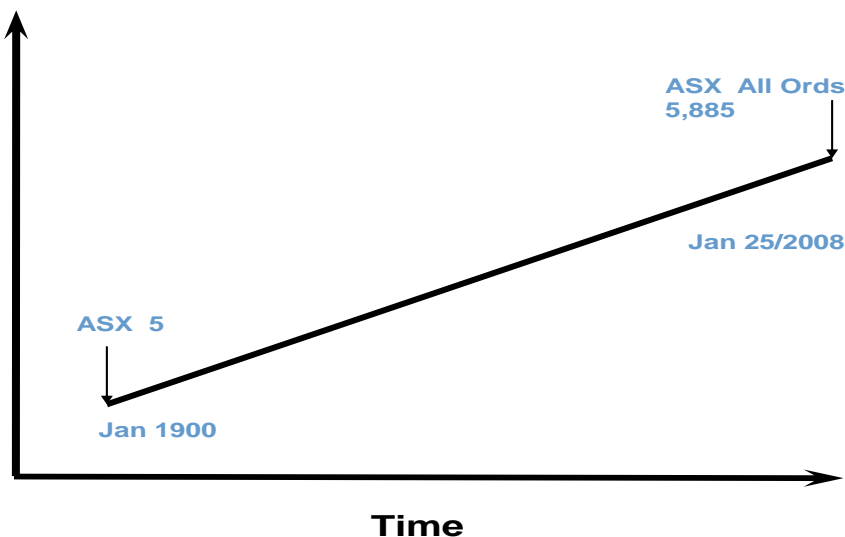
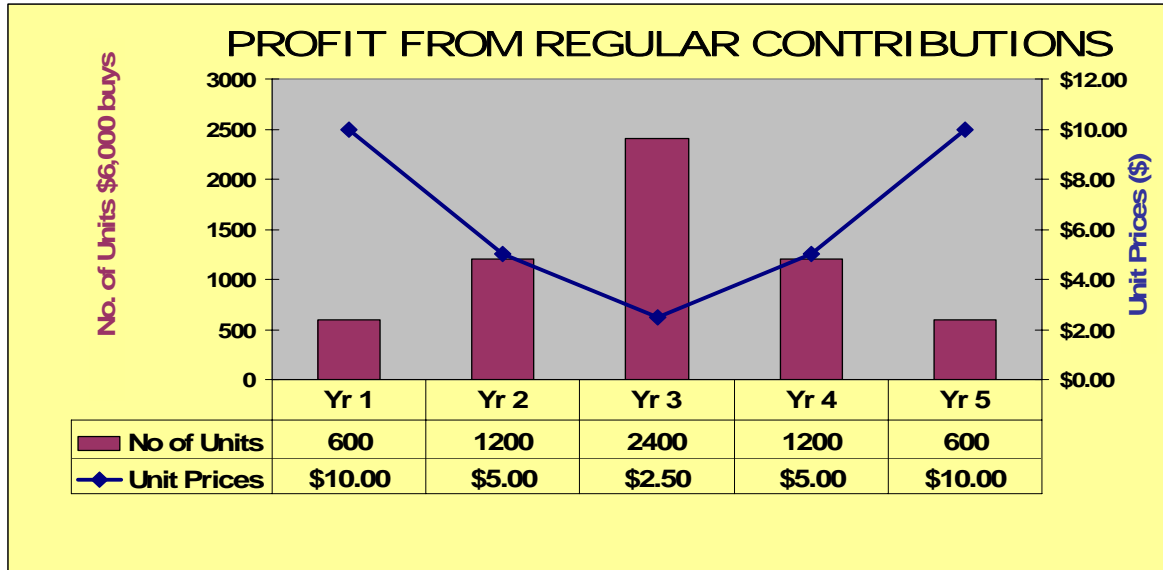


Fig showing Historical Trends using the ASX All Ords Index Values

**Regular Savings - Dollar Cost Averaging**

Regular savings (monthly contributions) can be very effective in volatile markets. As the graph shows, when the unit or share price falls, your savings will buy more units in a managed fund - and that means more profit when the market bounces back.



Example shown above, is for a contribution of \$6,000/year over 5 Years in a falling market:

**Example 1**

Lumpsum Investment of \$30,000 in Year 1  
 Year 1 Unit Price \$10  
 Year 5 Unit Price \$10  
 Year 5 Value: \$30,000  
 Growth: Nil

**Example 2:**

Yearly Investment \$6,000  
 Year 1 Unit Price \$10  
 Year 2 Unit Price \$5  
 Year 3 Unit Price \$2.50 etc  
 Year 5 Value: \$10x6,000 Units = \$60,000  
 Profit: \$30,000

**Where to from here?**

What this comes down to, of course, is that your investment plan will need to be reviewed and revised to come to terms with 2008. If you have not embraced the short side of the market, it's time to pay attention to these opportunities. You are encouraged to meet with your Adviser to identify knowledge gaps and devise a plan to overcome them. As with every year, 2008 will present opportunities and challenges. And as always, it will be a matter of how effectively we deal with them.

**If you need help with a review of your Super or Managed Funds or other wealth creating strategies, please call Jillian, Donna, Sue or Dominic on 0249 625 814.**

From all of us at Independence Group, here's to a great 2008 and a healthy outcome in your investment portfolio.

Happy Investing!

Article By: Oscar Aguiar – Independence Group

**WARNING:** The results shown by the various spreadsheet calculators are an approximate guide only and should not be used as exact values for financial planning purposes. You are advised to consult with your own independent financial and/or investment adviser before making a decision regarding the acquisition or disposal of a Financial Product.

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