Market Update

3 tips for handling bumpy financial markets

17 February 2016

Investing in 2016 might feel a bit disarming after strong Australian and global share returns from 2009-2014. Our experts continue to expect 'lower returns and higher volatility', but provide 3 tips for investors to handle bumpy financial markets and stay focused on long-term goals.

What's driving the market downturn?

Global equity and credit markets have been very volatile since the beginning of the year. **At Russell Investments, our view is that markets have over-reacted and should rebound when sentiment improves**.

We believe it's a combination of fears around the health of the Chinese economy, US recession concerns, the US Federal Reserve (Fed) 'tightening' (i.e. increasing interest rates), bank balance-sheet worries and poor corporate profits. In contrast, the move to negative interest rates in Europe and Japan has triggered fears that central banks have run out of 'easing' options to lower interest rates further, and by hurting bank profitability, could make things worse.

Despite global market volatility and the larger than expected sell-off in global equity markets, we are inclined to focus on underlying economic fundamentals, which for now in our view, remain intact.

How should investors feel, think and act in such volatile times?

1. It's normal to feel rattled.

Fear and worry are natural reactions when markets are rising one day and falling the next.

Investment markets are driven by emotion. Negative or 'bearish' headlines erode investor confidence, which in turn reinforces selling pressure and generates more bad news. And on and on it can go into a downward spiral. Even the most seasoned investors get rattled by volatile conditions and can make knee-jerk decisions when their investments aren't performing.

All investors want to achieve high, risk-free returns. But investing requires a trade-off between risk and return. To grow the value of our investments over time, we generally need to adopt a strategy that is riskier than we'd prefer—which is why we react so strongly to seeing the value of our savings rising and falling day to day and week to week.

2. 'Cashing out' is a risky move.

Volatile investment market conditions trigger one of our most primeval protective instincts – we can't **fight** the performance of investments, so we often adopt a **flight** strategy by switching our investment strategy. That's why investor behaviour in volatile times is often termed a 'flight to cash'!

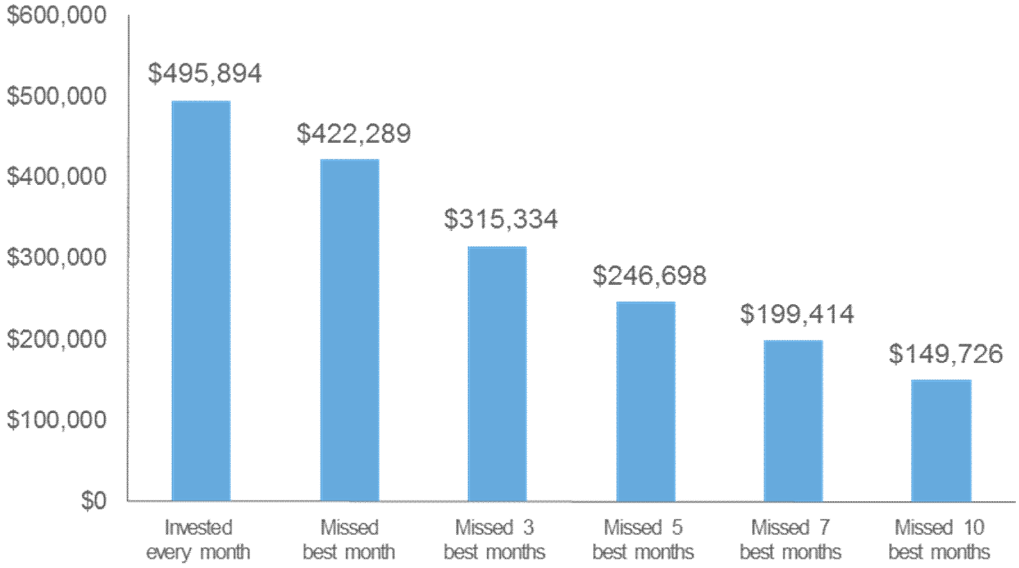
But switching to a lower growth investment strategy, e.g. cash, during periods of volatility is rarely in investors' best interests, and it may actually see you worse off at retirement.

Yes, switching to a lower-risk investment strategy can protect your savings from future investment losses. But it's also likely to cause you to lock in any losses up to that point. It's unlikely that you'll able to pick the right time to switch back to a higher-risk strategy when conditions go back to normal. By the time you hear good news in mainstream media, any rebound will be well underway.

Missing just the single best month in the Australian shares market over the last 35 years would have cost investors approximately 15%.

Exhibit 1 shows six potential outcomes of investing $10,000 in the Australian sharemarket from February 1980 to 31 July 2015. The chart shows the effects on the investment of missing the best performing months – the difference is quite substantial.

Exhibit 1: Timing or time in?



Past performance is not a reliable indicator of future performance. S&P/ASX 300 Accumulation Index.

If you 'cash out' when markets are down, you are choosing to 'sell low'—the opposite of the common goal of investors to 'buy low and sell high'.

While volatility makes us uncomfortable, periods of unpredictable performance are perfectly predictable – from time to time, investment performance will be volatile.

3. Stick to your guns and follow your financial adviser's guidance.

After assessing your individual circumstances, your financial adviser will work with you to select the most appropriate investment strategy to help you meet your objectives.

An investment strategy based on your long-term investment goals will help you avoid the buy-high, sell-low mindset that sees most investors invest at the point of maximum risk, and shy away at the point of maximum opportunity.

If you're invested in one of our Diversified portfolios, volatility can actually present an investment opportunity, because you have the opportunity to increase your exposure to growth assets when these are likely to be priced by the market at less than true market value. They say fortune favours the bold, but it's worth seeking professional advice from your financial adviser if this is a strategy you're considering.

What's Russell Investments doing to manage portfolios for investors?

Our international team of investment strategists and portfolio managers constantly monitor and assess investment markets, economic data and investor sentiment across each of the regions where we invest your money. This global reach helps us to adjust and optimise the underlying investment managers and assets *within each of our portfolios,* to ensure new opportunities that help achieve our portfolio outcomes are captured and emerging risks are avoided.

Diversification plays a key role in minimising the impacts of volatility, by spreading investments across a wide range of asset classes and investment managers across many different countries.

Our portfolios also employ downside protection strategies when appropriate, which means **we may implement protective changes *ahead* of market downturns in some cases**.

Summary

As stated in our *2016 Global Market Outlook*, we expect this year to present a challenging environment. However, we expect the global market to recover from these lows, as market fears of an impending global recession fade, much like we saw following the weakness in August 2015.

Ultimately, it's important to keep your personal long-term objectives in mind so we recommend you continue working with your financial adviser to stay on track.

Want to view additional market perspectives?

- Stay up-to-date with Market Week in Review videos.
- View our latest market review.
- Read a summary of our 2016 outlook, '3 rules for the road: Signposts for investors in 2016'.

FOR FURTHER INFORMATION:

Please contact your Financial Adviser.

First used: February 2016. AUST1-2016-02-17-0471