Fact Sheet: Understanding volatility

When financial markets experience an upward or downward spike it can be difficult not to get caught up in the hype. From attention grabbing news headlines to predictions from industry economists – it seems everyone has a different opinion on what the market will do next and the action you should take. But when it comes to your superannuation, the best strategy is to remain focused on the long term.

How you react to volatility will ultimately affect your investment balance, so try not to be swayed by short-term market fluctuations, or the opinions of others.

Superannuation is a long-term investment. Generally speaking, what occurs in today's market is not likely to have a significant impact on your super investments over the longer term. And for most people, long term does not mean one, three or even five years but more like 20, 30 or 40 years.

It's also important to remember that investment markets move in cycles and it is impossible to predict when a market will rise or fall. However, by looking at the historical performance of the share market, we can see that despite short-term volatility, the market always recovers over the long term.

A good example of such a recovery is the share market crash of 1987, when the ASX All Ordinaries Index fell 25% in one day and continued to lose ground over the next five months. It took six years for the market to regain its value, but since then the All Ordinaries has risen around 229%[1]. Another, more recent, example is the global financial crisis of 2007-08. Global share markets fell as much as 51% from their peak during the crisis and took five-and-a-half years to recover. However, since then they have returned around 93%[2].

While it may be tempting to withdraw from the market as a reaction to sudden events, it means you will miss the market's recovery, which can sometimes happen unexpectedly. So, investing for the long term certainly has its merits.

Aside from taking a long-term approach, there are other ways you can safeguard your investments against volatility.

Diversification

You can mitigate some levels of risk created by market movements through diversification. By spreading your portfolio across multiple asset classes, you can reduce your dependence on a single asset's performance. This means a drop in the value of one investment can be offset by gains in another.

Asset classes and investment styles vary from year to year, which means even the best individual money managers aren't necessarily on top for extended periods of time.

Even if you have access to superior research on managers, it is difficult to predict when one style will outperform another.

So, it makes sense not to put all your eggs in one basket and instead diversify your investment across a range of different managers.

Russell Investments helps you do this by diversifying across a range of asset classes, investment styles and money managers, and mixes them together to give you a single diversified portfolio. Diversification is proven to reduce the risk of underperformance and provide more stable returns to investors.

Making regular contributions

Did you know that investing the same dollar amount at regular intervals can help smooth out the ups and downs of markets? Investing this way, known as 'dollar cost averaging', means you purchase more shares or units when prices are low and fewer when prices are high.

If you are making regular contributions to your super, you are already taking advantage of this proven investment approach. You don't need a lot of money to commence a dollar cost averaging strategy. By making small, regular contributions over time, you might be surprised by how quickly your balance will accumulate. Using this strategy also means that your contributions automatically buy more units when prices are lower and fewer units when prices are higher.

Anything else?

Russell Investments manages your superannuation with a long-term approach that focuses less on the cyclical nature of investment markets. Sound investing is based on balancing risk with return and all investments carry some level of risk. However, we believe risk can be managed to provide more consistent investment outcomes.

[1] Cumulative return as at 31 December 2019.
[2] Cumulative return as at 31 December 2019. Global shares measured by the MSCI World ex Australia Net Accumulation Index (in local currencies).

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