Point of view

Mark Dutton, Chief Investment Officer – AXA Australia

Surviving and thriving in a world of uncertainty

Faced with many uncertainties and a faster pace of change than ever before, some investors may feel concerned about their investment strategies. In this Point of View, AXA's Chief Investment Officer Mark Dutton looks at how to not just survive, but to thrive in times of uncertainty and change.

What if you could have seen the past 25 years before it came?

For many investors, fears are still high now because of uncertainty about how the world's current economic problems will play out.

Imagine that we could remove that uncertainty, and list with absolute confidence all of the problems and solutions that would occur over the next 25 years.

Would we feel more or less confident?

Try it by winding the clock back. If we could have seen the events of the past 25 years before they came, the list would look very intimidating.

It would have included the 1987 Australian sharemarket crash, which saw our market collapse by more than 40 per cent in two weeks. The early 1990s included recessions and the demise of several building societies and financial institutions.

Financial crises gripped most of Latin America in the 1980s, Western Europe in the 1990s, and Mexico in 1994-95. The Asian Financial crisis in the late 1990s threatened the economies of many of Asia's new rapidly emerging markets, saw currencies collapse, and financial systems under threat throughout the region.

Russia defaulted on its government bonds in 1998, and the world's largest 'hedge fund' – Long Term Capital Management – collapsed with large debts owed to most major Wall Street banks.

The dot-com bubble in the early 2000s saw more pain on global share markets. Corporate scandals saw huge organisations such as Enron and Worldcom buckle, with Australia also seeing the collapse of high profile names such as HIH insurance, Ansett Airlines, and OneTel.

Throughout this period there was also global political turmoil, including the fall of the Berlin Wall, the collapse of the Soviet Union, two Gulf Wars, the September 11 attacks and the 'war on terror'.

The GFC and the subsequent European debt crisis are but the latest in a long line of unsettling global financial events.

Would you have had the courage to invest if you saw all this coming?

In practice, knowing that all these events would happen is not enough. The natural reaction to the prospect of such bad news may be to stay away from investment markets altogether.

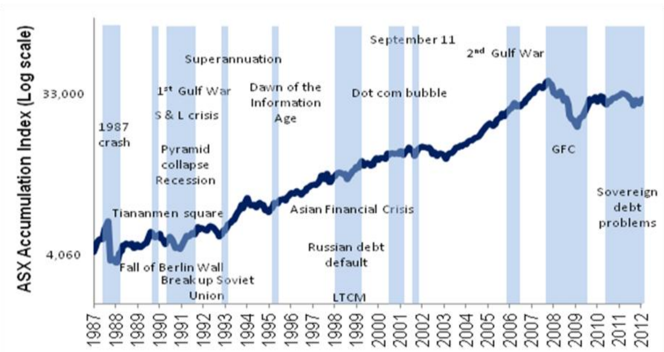
The full picture of the last 25 years shows that this decision would have involved missing one of the strongest quarter centuries in wealth creation in modern history.

Figure 1 below shows the growth of the Australian sharemarket since the beginning of 1987. Taken over the longer-term we can again see how the markets climb the 'wall of worry'.

Despite all of the crises, companies continued to produce goods and services, and sharemarkets produced strong real returns.

Over the past 25 years, the Australian sharemarket has delivered a total return of almost 700 per cent – equivalent to a return of nearly 9 per cent compounded per annum.

Figure 1: The Australian sharemarket since 1987



Source: AllianceBernstein and Datastream. Monthly data from 31 January 1987 through to 31 January 2012.

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Unforeseeable advances?

The past 25 years have seen advances in global growth dynamics, population growth, technology, medicine and communications that could not have easily been imagined.

Who, 25 years ago would have seen China about to become the world's largest economy, life expectancy extend by around 7 years, and computers to become present in almost every house, car and machine?

Who would have expected that the world's largest music store would not be a store, but a website? Or that a 'virtual' community such as Facebook could grow from a start up in 2003 to be the third biggest 'population' in the world? Or that the first Australian who will live to 125 years has probably already been born?

Advances such as these have caused major disruptions as well as opportunities for investors.

It's also important to recognise that some well known established companies can be resilient to big impacts, such as the GFC. For example, 125 year old Coca Cola, has been paying increased dividends for 49 consecutive years.

A restructured General Motors is now the largest car maker in the world, but now sells more cars in China than in the US.

In mining, oil and gas, Melbourne headquarted BHP is the world's largest company based on sales and revenue.

What does this mean for investors?

We can never be sure of the future before it happens. However, we can be fairly confident that change is occurring at a faster pace than ever before, and that this will present investors with different challenges and opportunities to the past 25 years.

<u>3 key strategies to survive and thrive</u>

1) **Align strategies with objectives.** Investment strategies may need to meet a number of objectives. In volatile times, risk is reduced if there are clear strategies to meet specific needs such as liquidity needs, regular income, longer-term growth and inflation protection. Good alignment can help avoid the desire or need to sell long term assets when markets are depressed.
2) **Diversify**. Diversification remains a powerful means of reducing investment risk. To capture the benefits of diversification, investment strategies need to take into account that different asset classes provide a proxy for risk, but do not form the underlying risk itself.
3) **Be clear on risk concerns and behave ourselves**. Short term volatility captures the headlines and may trigger poor, emotionally driven decisions, but is it really important?

   If strategies are aligned with needs, the short term volatility of long term strategies may be the wrong measure of risk.

   A clear plan is a good tool to help maintain the discipline needed to create wealth over time.

   Problems and opportunities will occur frequently. Research tells us that problems will attract attention more than opportunities.

   A key advantage to having sound investment strategies in place is that it provides access to changing market opportunities without having to 'foresee' and react to exactly what is going to occur.

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