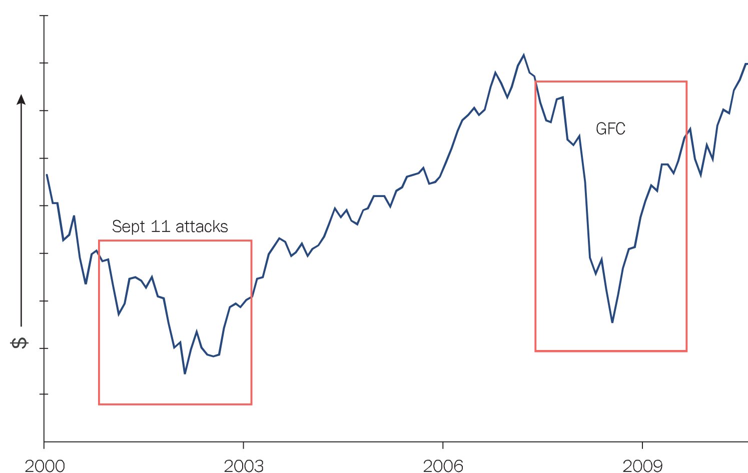
Investment Fundamentals

The benefits of long-term investing

Financial markets can be volatile; however history shows that holding investments over the long term rather than trying to predict when markets will rise and fall, means you can be more likely to achieve your long term financial goals.

Long term investing means you minimise changes to your chosen investments through both the good and bad times. It involves allowing your portfolio to grow over many years instead of reacting to daily market movements, known as market volatility.

Graph 1: Portfolio value of 60% equities and 40% bonds.



Source: Equities represented by Standard & Poors (S&P) 500 Index and Bonds Bloomberg Barclays Global Aggregate Bond Index [USD].

Market volatility

In the short term markets can be volatile, however over the long term, history has shown that markets tend to move in cycles. While markets can face periods of rapid decline, they eventually recover and move on to reach new highs. For example, the market down turns following the September 11 terrorist attacks in 2001 and the global financial crisis (GFC) of 2008 were both eventually followed by strong market recovery, as Graph 1 illustrates.

Benefits of long term investing

When you look to invest, the cliché is that you aim to buy when prices are low and sell when the prices are high. However we're all human and this can be very difficult to do consistently for two reasons:

- we are influenced by our emotions; and
- investment markets are very difficult to predict.

The case study on the following page illustrates the benefits of sticking with a long-term investment strategy and not letting emotions guide your investment decisions.

The impact of transaction costs and taxes

As part of your investment strategy your adviser can guide you on ways to minimise the impact of the costs of running your investments. Long term investing can assist to achieve this. When you buy and sell investments you usually incur transaction costs. Since long term investments are held for longer periods, they are likely to incur fewer transaction costs.

Similarly, there may be tax benefits to long term investing by minimising the capital gains tax (CGT) payable. If you sell often, assuming a profit, the tax payable and these costs can add up over time.

Transaction costs and taxes may have less of an impact on long term investors than they do on short term investors.

Your adviser can help you

Your adviser will work with you to develop a strategy to assist you to achieve your needs and objectives. This includes:

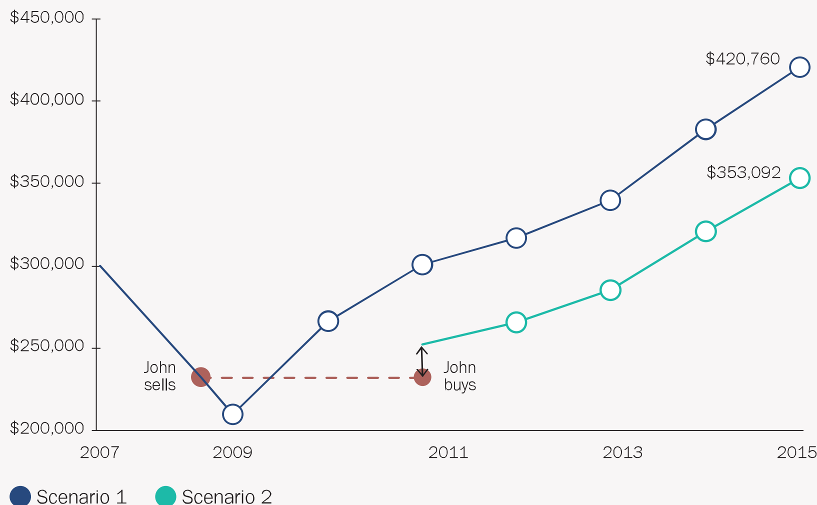
- Recommending appropriate investments with a focus on long term growth; and
- Recommending the best strategies to help reduce costs.

Long term investing does not mean doing nothing all the time. Your portfolio should be regularly reviewed and periodically rebalanced to deliver to your original targets.

Case study

Let's look more closely at the market movements around the GFC. John had investments worth $300,000 in September 2007.

Graph 2: Portfolio value of 60% equities and 40% bonds.



Source: Equities represented by Standard & Poors (S&P) 500 Index and Bonds Bloomberg Barclays Global Aggregate Bond Index [USD]. Term deposit rate calculated as average of all maturities from October 2008 to February 2011 – RBA.

Scenario 1 – John holds his investments over the long term

John's adviser recommends that he holds his investments over the long term to meet his retirement goals. John does this and he is able to rest easy despite the market volatility. You can see in Graph 2 that by February 2015, John's investments were worth $420,760. John earned $120,760 over the period towards his retirement.

Scenario 2 – John is influenced by emotions

As the impacts of the GFC began to be felt, John's investments started to fall. John lost sleep and nervously watched the markets daily to see how prices would move. John, fearful of losing his retirement savings completely, sold his investments and put the proceeds into a high interest bank account instead[1]. John's fear led him to sell his investments when prices were very low[2] even though the markets continued to decline for a further 5-6 months. However, the market recovered and John had eventually regained enough of his confidence by February 2011. He was interested again in the prospect of rising prices and watching his nest egg grow. John bought back into the market[3]. By February 2015, John's investments were worth $353,092[4] instead of $420,760. Had John listened to his Adviser and stayed in the market, he would have had an additional $67,668[5] for his retirement.

Assumptions

1 Interest of $20,004 calculated using an annual rate of 3.71% based on average RBA savings account rates on all maturities between October 2008 to February 2011.

2 Proceeds from sale were $232,192. This assumes no brokerage and exit-fees incurred on the investments held in the portfolio.

3 John bought back in using the proceeds from the original investment $232,192 plus interest earned on the term deposit equalling to $20,004. The total investment at the end of February 2011 was $252,196.

4 John invested $300,000 in September 2007. Giving into emotions he cashed out of the market in October 2008 losing around $67,808. He placed the withdrawn funds into term deposit for 2 years earning $20,004. He bought back into the market with $252,196 (Principle and interest: $232,192 + $20,004) sighting recovery in February 2011. He earned $100,896 organically till February 2015. This makes the final value of the portfolio as $353,092.

5 John's earnings to retirement, in Scenario 2, of $53,092 are based on the final value of his investments of $353,092 less what he started with $300,000. In Scenario 1, John earned $120,760. $120,760 less $53,092 = $67,668.

Important information

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