

Understanding your investments outcomes in times of stress

BY STEPHEN MCFARLANE

As Covid-19 sweeps the world and governments and individuals everywhere take steps to protect themselves and others there are additional stresses for many on income and concern as to what the future holds.

Added into this mix is concern as our KiwiSaver and other investments have fallen in value. What does this mean? Will our values recover? Should we make changes? I was planning to buy a house? Is my retirement still on track?

It's important to know these thoughts and worries are normal human behaviour. And knowing that allows us the opportunity to observe the anxiety and put it aside rather than living within it.

A second step is to consider whether our fears and concerns are grounded in fact.

Our investment values have fallen. We might feel like those losses are permanent, that they won't recover, that values could keep falling until we have nothing left. How likely are those outcomes? The answer is that it is likely that these big concerns won't happen.

There has never been a Covid-19 before. But there have been other viruses and a multitude of other crises which have caused investment values to fall. And each time the world has adapted and ultimately continued to grow as the crisis passes. It will do so again. That is demonstrated in the graph of the New Zealand share market below. Since 2000 it has risen substantially. There have also been periods of negative returns along the way. But each time there has been recovery as well.

The key question is not "will investment values recover?" It is "when will they recover?"



Source: Bloomberg, NZSE40 Gross Index (to January 2001), S&P NZX 50 Portfolio Index (from January 2001)

You may have specific questions:

PERHAPS IT'S DIFFERENT THIS TIME

It is true that Covid-19 is having a significant impact on businesses and the economy and therefore the value of our investments. But it's reasonable to believe a vaccine can be produced, economic activity will resume and investment values will improve.

WHY IS MY KIWISAVER BALANCE FALLING?

In general, fluctuations in value are normal and are to be expected. KiwiSaver and other managed funds are not like a bank account. They are an investment account where you buy units in a fund that makes investments, such as shares, bonds and property. Your provider invests your money (depending on your chosen fund type) and the value at any given time depends on the worth of the investments. At present, investments are worth less due to the fears around Covid-19 and concerns about its economic impact around the world.

WHY IS THE SHARE MARKET FALLING?

Shares are valued depending on investors' outlook on a company's ability to make money in the future. Around the world, share values are reacting to concerns around Covid-19 and the economic impact.

WILL MARKETS KEEP FALLING?

Investment markets are likely to be volatile for some time to come. Perhaps until a vaccine becomes available. But if you have a strategy in place that matches your timetable, financial objectives and risk profile, you should stick with it – over the longer term, the current market swings will become far less relevant.

I WAS ABOUT TO ACCESS MY KIWISAVER BECAUSE I AM BUYING A HOUSE

Sometimes unexpected events get in the way of our plans. You will still be able to access your KiwiSaver. The question arises as to whether there is greater value in waiting for market values to recover in part or whole.

Additionally, good KiwiSaver planning seeks to ensure that your intention to buy a house is built into your fund choice (more conservative) and thereafter your KiwiSaver moves to being more growth orientated as it focuses on retirement years down the track.

If you are thinking about a house purchase in the next three to five years, seeking advice to assist with decision making is generally a good idea.

I HAVE PLANS TO RETIRE. WHAT DO I DO NOW?

The answer to this question will depend on how far away retirement is and the extent to which your investments are growth orientated or you have been moving to a more conservative position over time.

Seeing your investment value dropping can be disconcerting, and even stressful, when it feels like your retirement needs mightn't be met. Do I have to keep working? What are my choices?

It's important to remember that you don't spend all your retirement funds on the day you retire. In other words, your funds will be spent over a longer period of time and likely a large proportion will be spent well after markets have recovered in value.

Being able to look into the future with your current retirement wealth and know how much you can spend and how long it will last in various market circumstances is important. Software exists that allows that future to be projected. If doing that would be good support for you, then I can help.

PERHAPS I TOOK ON TOO MUCH RISK?

For some investors, investments fluctuating in value don't concern them. They know they have a longer-term focus and are prepared to weather the storms for the opportunity to earn a better long-term return.

For more conservative investors, the volatility can be much more stressful and they are prone to worrying that their values might continue to decrease and that ultimately their investments could be lost in whole or in large part.

Understanding your core investment personality is important. As is getting advice to ensure that your perceptions of the investment world are correct. It can be costly, if you are a longer-term investor, to be more conservatively invested than you are capable of.

We also need to be careful of labels. Whether you are a conservative, moderate or aggressive investor – if you are invested in KiwiSaver or a well-diversified managed fund, then each of those choices can be inherently more "conservative" versus owning one rental property, or owning just a handful of shares, all based in one sector or country. And while bank deposits might appeal, they have their own risks in terms of lower returns and therefore not sufficiently meeting your longer-term financial objectives.

Your KiwiSaver and investments in professionally managed funds are in the main well-diversified and any material and permanent capital loss should be unlikely over the long-term. More likely is that the value of your investments will be volatile now and for some time ahead.

If you feel like the current volatility is beyond your comfort levels, or you are interested in understanding the diversification or risk level of your investments, then the best thing you can do, before making any decisions, is to seek advice. My contact details are at the end of this message, if I can be of help.

SHOULD I SWITCH MY KIWISAVER FUND TO ONE THAT'S LOWER RISK?

Lower risk generally means an investment that has a smaller allocation to shares.

Have you had a change in circumstances? If not, then don't make any hasty decisions. In general, it is time in the market, not timing the market that will make you better off.

Currently the falls in investment values are just a number on a page (albeit an uncomfortable number). However, you can permanently lose a portion of your investment wealth if you sell at that low price. You have "locked in the loss".

Additionally, while switching to a more conservative fund may help avoid any future falls in value, you are also giving up the opportunity to fully participate as markets recover.

I'VE SWITCHED TO A CONSERVATIVE FUND; IF THE MARKET GOES UP AGAIN, SHOULD I SWITCH BACK TO A BALANCED OR GROWTH FUND?

History shows that its near impossible to time the market. We don't know when the market will 'bottom out' but research tells us that most people who switch to conservative will miss out on much of the upside as they will wait too long to get back into a growth fund.

I DON'T HAVE CONCERNS. BUT I'M WONDERING IF THERE ARE ANY OPPORTUNITIES IN THE CURRENT MARKET AND WHETHER I SHOULD BE PROACTIVE WITH MY INVESTMENT STRATEGY?

While the timing is uncertain there is no doubt that investment markets will recover in value over time. Some investors will want to take that opportunity to increase their savings rate now while values are depressed, to invest lump sums or to consider switching their KiwiSaver or other diversified investment choice towards a higher weighting to shares and other growth investments.

While current market fluctuations do present opportunities, seeking advice before making changes is recommended.

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Conclusion

My personal approach in times like this is simple – I don't check my investment values. Yes, they are lower. But my KiwiSaver and my professionally managed funds are very well diversified and managed. My risk is spread. The current value is just a number on a page. Yes, that number represents what I could sell my investment for today and that is lower. But if you (like me) are not needing to spend the funds today or in the near term then today's value is not relevant.

I have faith that this crisis will pass, my investment values will recover, and the world will carry on. And as the world fully recovers, I will once again look up my investments to see what they are worth.

I also remember what I think is the most significant piece of investment advice I have heard on the pandemic. That this is a crisis with an end point. That end point is when a vaccine or other treatment becomes available. At that point we will be able to leave our homes, resume our activities, begin to trade and spend again. One day COVID-19 will be well in our rear vision mirrors. And our investment values will in all probability have recovered and moved to new heights. We will wonder what we were worried about.

Support

If you have questions or concerns (or perhaps want to be proactive in the current market) please do contact me. There is no charge and no question is too big or too small.



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