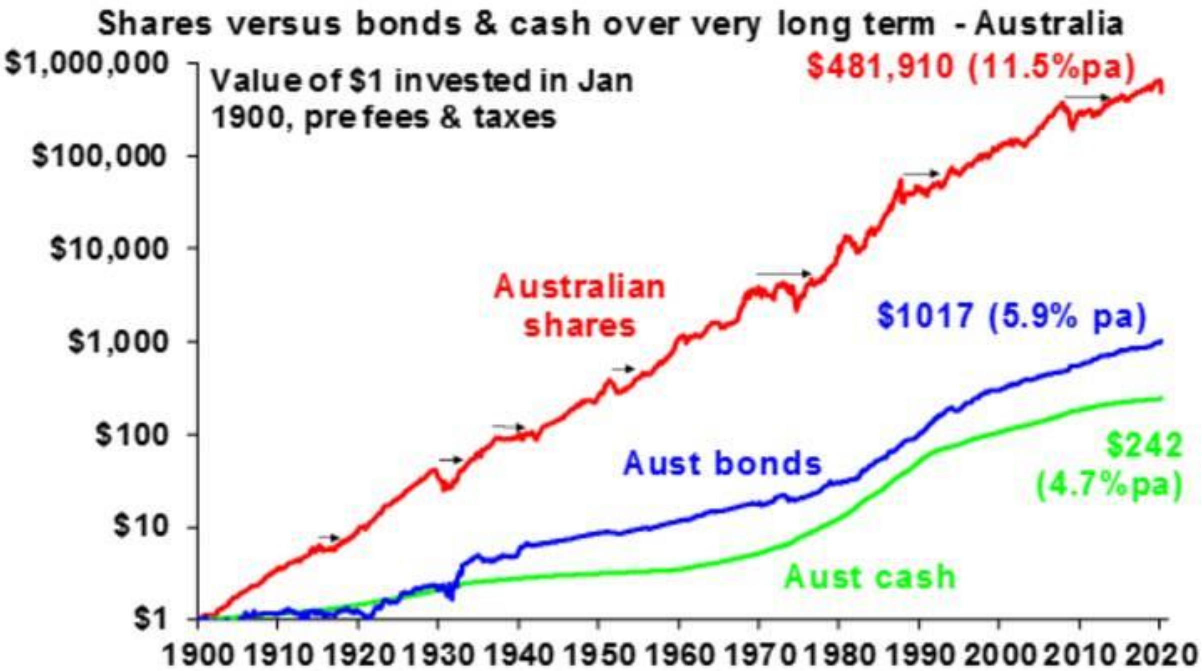
Chart #1- The power of compound interest

This is my favourite chart. It shows the value of $1 invested in various Australian assets in 1900 allowing for the reinvestment of dividends and interest along the way. That $1 would have grown to $242 if invested in cash, to $1017 if invested in bonds and to $481,910 if invested in shares. While the average return since 1900 is only double that in shares relative to bonds, the huge difference between the two at the end owes to the impact of compounding - or earning returns on top of returns. So, any interest or return earned in one period is added to the original investment so that it all earns a return in the next period. And so on. I only have Australian residential property data back to 1926 but out of interest it shows (on average!) similar long term compounded returns to shares.

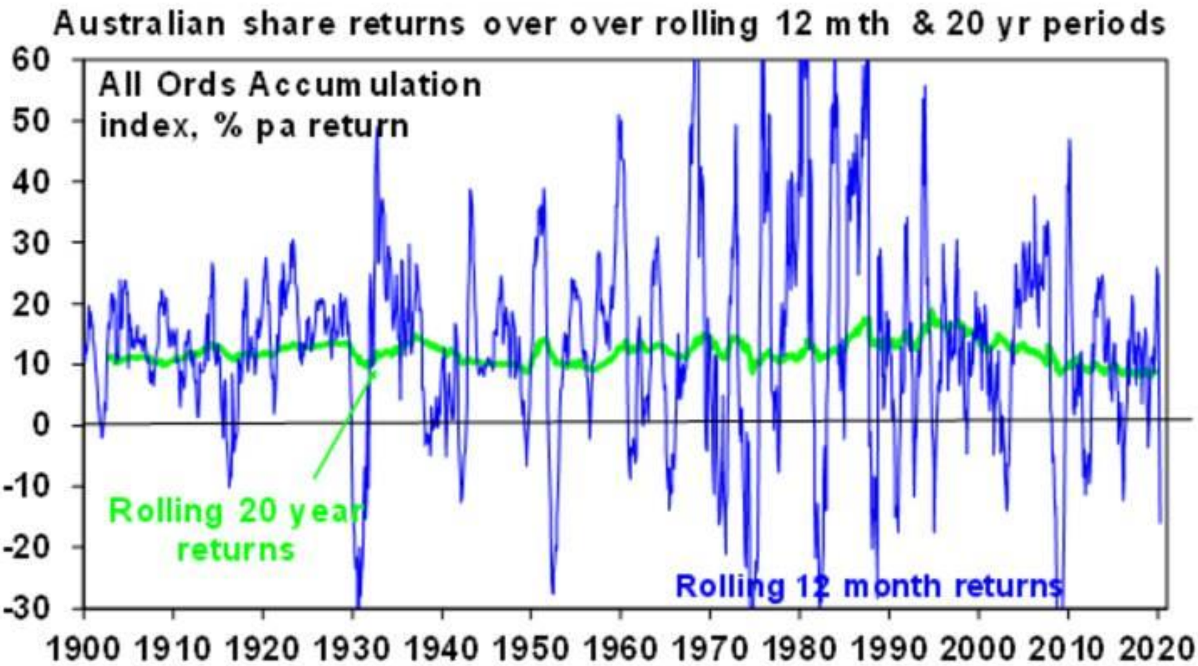


Source: Bloomberg, AMP Capital

Key message: to grow our wealth, we must have exposure to growth assets like shares and property. While shares have collapsed lately amidst massive coronavirus uncertainty and the short-term outlook for Australian housing is vulnerable too, both will likely do well over the long-term.

Chart #2- Don't get blown off by cyclical swings

The trouble is that shares can have lots of setbacks along the way as is evident during the periods highlighted by the arrows on the previous chart. Just like now. Even annual returns in the share market are highly volatile, but longer-term returns tend to be solid and relatively smooth as can be seen in the next chart. Since 1900, for Australian shares roughly two years out of ten have had negative returns but there are no negative returns over rolling 20-year periods.



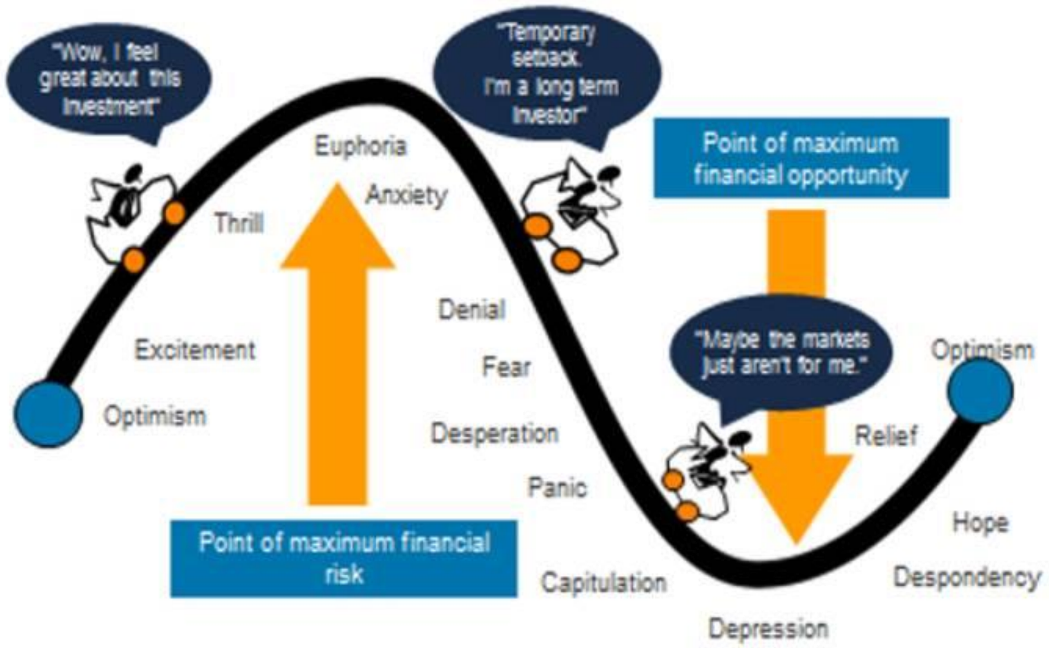
Source: Bloomberg, AMP Capital

The higher returns shares produce over time relative to cash and bonds is compensation for the periodic setbacks they have. But understanding that these periodic setbacks are just an inevitable part of investing is important in being able to stay the course and get the benefit of the higher long-term returns shares and other growth assets provide over time.

Key message: short-term sometimes violent swings in share markets are a fact of life but the longer the time horizon, the greater the chance your investments will meet their goals. So, in investing, time is on your side and it's best to invest for the long-term when you can.

<u>**Chart #3- The roller coaster of investor emotion**</u>

It's well known that the swings in investment markets are more than can be justified by moves in investment fundamentals alone - like profits, dividends, rents and interest rates. This is because investor emotion plays a huge part. This has been more than evident over the past few weeks. The next chart shows the roller coaster that investor emotion traces through the course of an investment cycle. Once a cycle turns down in a bear market, euphoria gives way to anxiety, denial, capitulation and ultimately depression at which point the asset class is under-loved and undervalued and everyone who is going to sell has – and it becomes vulnerable to good (or less bad) news. This is the point of maximum opportunity. Once the cycle turns up again, depression gives way to hope and optimism before eventually seeing euphoria again.

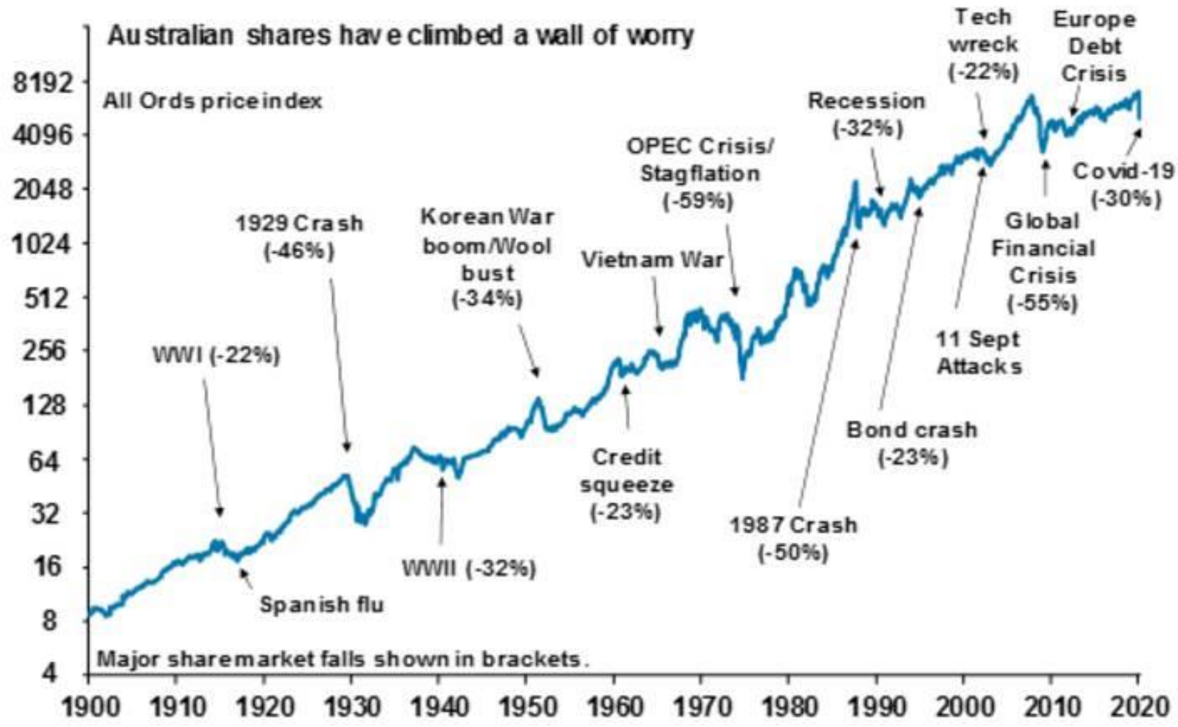


Source: Russell Investments

Key message: investor emotion plays a huge role in magnifying the swings in investment markets. The key for investors is not to get sucked into this emotional roller coaster. Of course, doing this is easier said than done which is why many investors end up getting wrong footed by the investment cycle.

Chart #4 -The wall of worry

There is always something for investors to worry about. And in a world where social media is competing intensely with old media it all seems more magnified and worrying. This is arguably evident now in relation to coronavirus uncertainty. The global economy has had plenty of worries over the last century, but it got over them with Australian shares returning 11.5% per annum since 1900, with a broad rising trend in the All Ords price index as can be seen in the next chart, and US shares returning 9.6% pa. (Note that this chart shows the All Ords share price index whereas the first chart shows the value of $1 invested in the All Ords accumulation index, which allows for changes in share prices and dividends.)

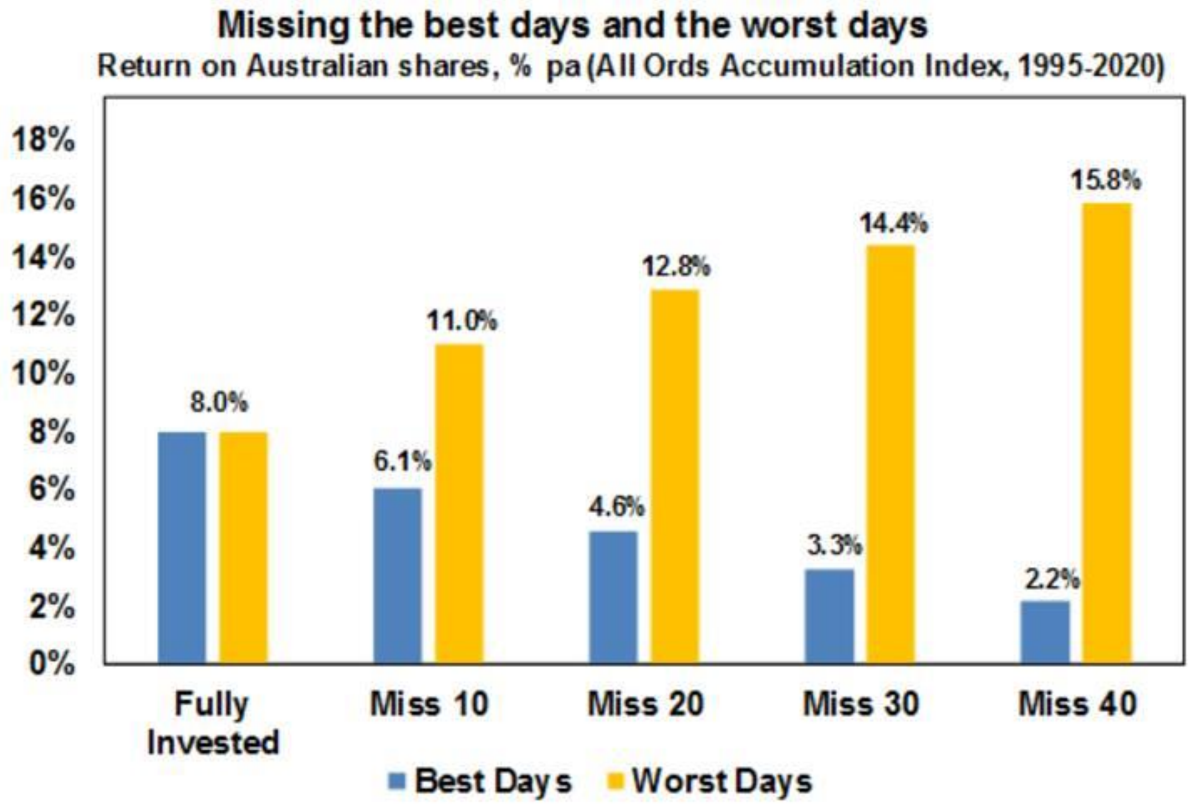


Source: ASX, AMP Capital

Key message: worries are normal around the economy and investments and sometimes they become intense – like now. But they eventually pass. For example, back in mid-January it seemed the bushfires, smoke shrouding our cities and regular news of homes and lives lost would never end. But when I went to regional NSW in the last week it was lovely, green and wet. And so, it is with coronavirus – this too will pass eventually.

Chart #5- Timing is hard

The temptation to time markets is immense. With the benefit of hindsight many swings in markets like the tech boom and bust and the GFC look inevitable and hence forecastable and so it's natural to think why not switch between say cash and shares within your super to anticipate market moves. This is particularly the case in times of emotional stress like now when all the news around coronavirus and its impact on the economy is bad. Fair enough if you have a process and put the effort in. But without a tried and tested market timing process, trying to time the market is difficult. A good way to demonstrate this is with a comparison of returns if an investor is fully invested in shares versus missing out on the best (or worst) days. The next chart shows that if you were fully invested in Australian shares from January 1995, you would have returned 8% pa (with dividends but not allowing for franking credits, tax and fees).



Covers Jan 1995 to 17 March 2020.
Source: Bloomberg,

If by trying to time the market you avoided the 10 worst days (yellow bars), you would have boosted your return to 11% pa. And if you avoided the 40 worst days, it would have been boosted to 15.8% pa! But this is very hard, and many investors only get out after the bad returns have occurred, just in time to miss some of the best days. For example, if by trying to time the market you miss the 10 best days (blue bars), the return falls to 6.1% pa. If you miss the 40 best days, it drops to just 2.2% pa.

<u>Key message:</u> Trying to time the share market is not easy.