HOLM TRUTHS

Down to earth advice for New Zealand savers and investors from independent journalist Mary Holm

SPRING 2002

Don’t Bail Out

Let’s say you’re on a long-distance run that you’ve never done before. At the end, there is a treasure chest – or at least there has been on all previous runs.

You know the route is varied. There are level parts, and some easy downhills. There are also some heartbreakingly tough climbs.

Not long into the run, you encounter a hill that is steeper than you expected. You round a corner, and the road continues upward. When will it ease up? And will there really be any treasure at the end anyway? Perhaps you should give up now.

Over the last couple of years, people who invested in international shares – or a fund or superannuation scheme that includes international shares – can probably relate to our runner.

The values of many world shares have fallen alarmingly since early 2000.

Most longer-term investors, who enjoyed huge gains in world share values through much of the 1990s, are still well ahead. But pretty much every new investor since the late 1990s is worse off than when they put their money in.

Some have already bailed out. Others are considering it. Don’t – unless you should not have been in there in the first place (See page 2). You’ll be committing the ultimate investment sin: buying high and selling low.

So what *should* you do? Firstly, look back to your thinkingwhen you first went into international shares or a fund that includes them. Why did you make that move?

There are two likely reasons:

• It gave you broader diversification.

When shares rise in one country, they often fall in another. Having your share investments spread around the globe reduces total volatility. This is an excellent reason. It hasn’t changed.

• You were attracted by world share performance.

And it certainly has been impressive. Returns on world shares including dividends topped 23% every year from 1995 to 1999 inclusive, while returns on New Zealand shares ranged from 20% down to minus 4%.

Since then, international shares are the ones that have gone into “minus territory”. And they have done it with a vengeance. The downturn has continued for a couple of years – an unusually long time, as the graphs on page 2 show.

Rest assured, though, that world share prices will rise again. When? Nobody knows. But they will. And you probably don’t want to be on the sidelines when it happens.

It’s helpful to recall, too, how long you intended to stay in world shares when you first invested.

Nobody except a gambler goes into a volatile investment like property, shares or a share fund for just a few years. There’s too big a chance you’ll lose some money – as recent experience shows. Assuming you’re not a gambler, you were in for the long haul. Now the market is testing you: Did you really mean that? Long-term winners answer, “Yes!”

HOW SOON WE FORGET

How does the recent boom and bust in world shares translate into dollars? Assume you invested $10,000 in world shares at the beginning of 1995, and reinvested the dividends, and you are in the 33% tax bracket.

You would have had about $29,700, after tax, at the beginning of 2000. That’s almost triple your original investment in just five years.

If you had put that money into New Zealand shares, you would have had $14,300 – only half as much.

Even if we extend the period to the end of June, 2002, the world share investment would still be better.

World shares certainly don’t always perform better than local ones. But nor is the reverse true.

WHEN YOU *SHOULD* SELL

There are exceptions to the Don't Bail Out message. While you shouldn't quit just because the market has been falling, there are two good reasons to get out of an investment in shares or a share fund:

- **Wrong type of investment for you**

Some people find they simply can't cope with market volatility.

If recent market conditions have left you sleepless, that suggests you should never have invested – or certainly not invested as much – in assets that will sometimes fall in value.

Given that you've lasted this long, you might try to hang in there. But if that idea is really unappealing, get out.

Others for whom world shares might be the wrong investment are those who find they will need to use the money in the next few years.

You might want to set yourself a plan to gradually reduce your exposure over, say, a year. That's often better than doing it all at once at what might turn out to be the bottom of the market.

- **Wrong shares or fund**

You might realise that you're invested in too few shares, or in shares in only certain industries, and you would be better off being more diversified. Or you might discover that your fund charges unusually high fees.

In these cases, there's no need to get out of world shares. You should simply switch to more suitable shares or funds. That way, you'll be selling low and buying low, which is okay.

But read on…

WHEN YOU *SHOULD* BUY

Back when you first invested in international shares, you should have done so with an eye on your other investments.

Ideally, you would have decided on your best "asset allocation" – the percentage of your savings that should go into cash, fixed interest, property, New Zealand shares, world shares and so on.

The allocation would depend largely on when you expect to use the money and how much risk you can tolerate.

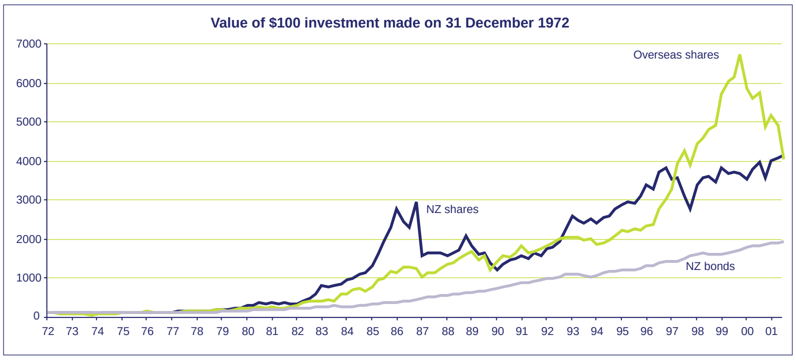
Let's say you decided 30% of your savings should be in world shares. Because of price declines, that holding might now make up just 20%.

If you are currently saving, you should direct most or all of your new savings into world shares, until they are back around 30% again.

This not only gets you back into balance, but you will be buying low. With any luck, you will later sell high!

Winners over the decades

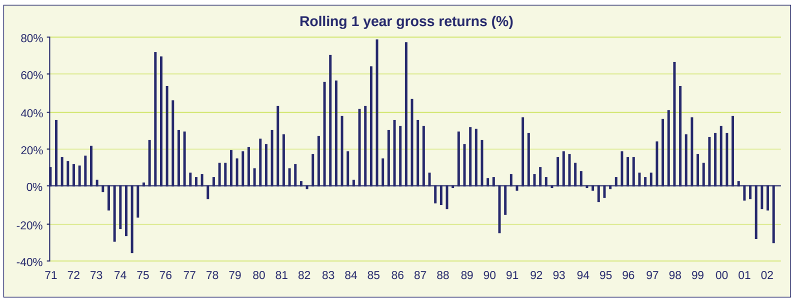
International shares have performed badly lately. And returns on both New Zealand and world shares are much more volatile than on bonds. But over 30 years, a $100 investment – including reinvested interest or dividends – would have grown twice as fast in shares as in bonds.

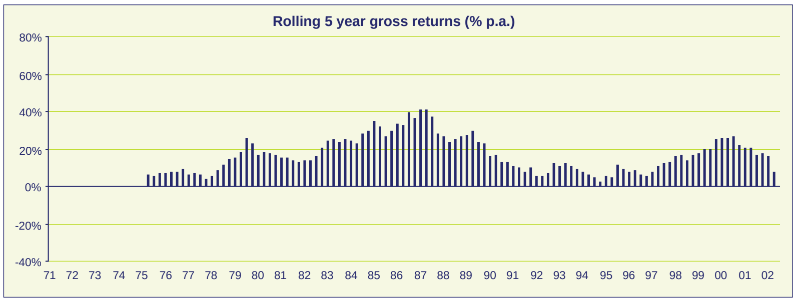


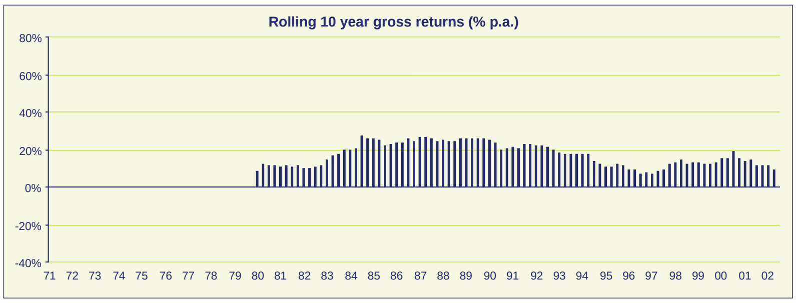
Long-term investment irons out the wobbles

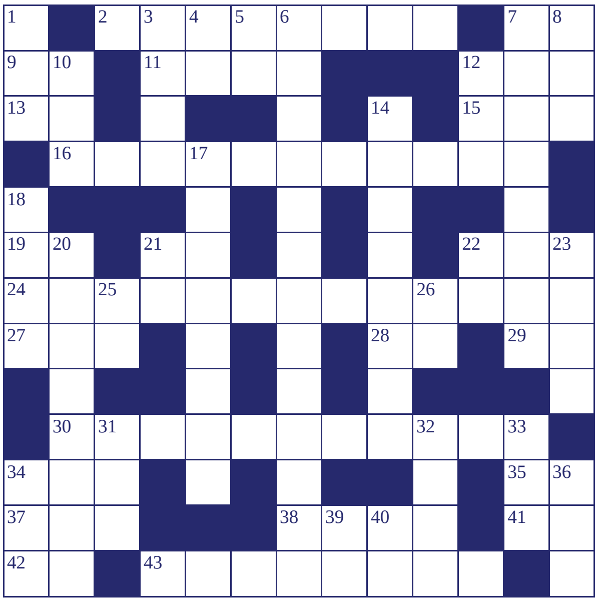
Returns on world shares (MSCI index including dividends) vary hugely over single years, in the top graph. They range from repeated losses recently and in the 1970s to impressive gains of almost 80% in the 1980s. There's much less volatility in average annual returns over 5-year periods, and less still over 10-year periods. While the huge gains are gone, in every 10-year period investors have enjoyed pretty healthy average annual returns.

A note on these graphs: There are four bars a year. In the 1-year graph, the first bar is the return for 12 months ending March 1971, the next is for 12 months ending June 1971 and so on. In the 5-year graph, the first bar is the average annual return for the five years ending March 1975, the next is for the five years ending June 1975, and so on.









Solution: Back page

HOLM TRUTHS CROSSWORD

Spring 2002

ACROSS

2. Nice tape (anagram) (8)
7. Corporation, firm (abbrev.) (2)
9. Not he or she (2)
11. Causes bad luck (4)
12. Crazy (3)
13. Negative answer (2)
15. I am, you _ _ _, he is (3)
16. Achievement, entertainment (11)
19. Not down (2)
21. Afterthought in letter (abbrev.) (2)
22. Opposite to 13 across (3)
24. What pirates seek (8,5)
27. Not his (3)
28. Youth's big trip (abbrev.) (2)
29. Very (2)
30. Other possibility (11)
34. Source of precious metals (3)
35. You and I (2)
37. Damp, rainy (3)
38. Tear (anagram) (4)
41. For instance (abbrev.) (2)
42. Newspaper boss (abbrev.) (2)
43. Break in school day (8)

DOWN

1. Come first (3)
3. Slightly open (4)
4. NZ tree or shrub (2)
5. Not out (2)
6. Outstanding (13)
7. Inattentive (8)
8. Poem (3)
10. Summit (3)
12. Slang for 14 down (3)
14. Wet weather gear (8)
17. Cracks (8)
18. Girl's name (4)
20. Scouts must be _ _ _ _ _ _ _ _ (8)
21. Maori village (2)
22. You (archaic) (2)
23. Cease (4)
25. Our queen (abbrev.) (2)
26. Not she (2)
31. To rent out (3)
32. Article, thing (4)
33. Sheep (3)
34. To be in debt (3)
36. Self esteem (3)
39. In all email addresses (2)
40. Same as 4 down (2)

GREAT DEBATE • GREAT DEBATE • GREAT DEBATE

TRADING vs BUY & HOLD

Frequent share trading is an enjoyable hobby for some people.

They buy on hot tips, get rid of holdings that are worrying them, learn how the market works, and sometimes make lots of money.

Some join share clubs, and enjoy the camaraderie.

But most traders should acknowledge that their hobby costs them something.

That's not to say they will necessarily lose money. Because share markets trend upwards over time, many share traders gain from their activities.

But the average trader would have gained more if he (and it usually is a he) had simply bought and held some shares for several years.

That's largely because of transactions costs. The frequent trader must repeatedly pay brokerage and other fees.

In New Zealand, they also have to pay tax on their capital gains, whereas someone who buys and holds would rarely pay that tax.

This can make a big difference. Over 20 or 30 years, an investor who pays 33% tax on gains might end up with about half the amount of someone who made similar returns that weren't taxed.

There's another cost for traders who use a computer programme to "tell" them when to buy or sell.

(CONTINUED PAGE 4)

TRADING PROS

- ✓ Short-term relief of worries
- ✓ Entertainment
- ✓ Education on the market
- ✓ Sometimes you win lots

TRADING CONS

- ✗ Time-consuming
- ✗ Increase risks that need to be managed
- ✗ Pay brokerage
- ✗ Pay capital gains tax
- ✗ Might miss market upturns
- ✗ Sometimes you lose lots

BUY & HOLD PROS

- ✓ Higher average returns, after lower costs
- ✓ Less attention needed
- ✓ Don't miss market upturns

BUY & HOLD CONS

- ✗ Discomfort in hard times
- ✗ Need patience

"Our capital markets are simply a relocation centre. They relocate wealth from the impatient to the patient."

Highly successful US investor, Warren Buffett

> *“Don’t try to buy at the bottom and sell at the top. This can’t be done – except by liars”.*

US investor Bernard Baruch.

(TRADING vs BUY & HOLD, CONTINUED)

Several such systems are available. There is no independent evidence that they work. And their cost, sometimes several thousands of dollars, certainly eats into any trading profits.

Sometimes, too, frequent traders – who are more inclined to invest money that they will need in the short term – are forced to take big losses if the market turns against them at the wrong time.

Those who buy and hold are more likely to be in a position to sit out a market downturn.

That doesn’t necessarily mean that sitting out is always easy.

In prolonged downturns, like the current one in world shares, some people get panicky if the value of their investment falls too far.

Buying and holding takes patience, and faith that things will get better. But most people who have tried the strategy for more than a short while find that it works best.

It has another great merit: It’s less work.

Albert Schwabacher Jr, (a large printer/stationer in San Francisco in the early 1900s) once said, “Most women would be better off if they paid less attention to their investments, not more.” To which we could add, “Men, too.”

A tick a tick a tick a tick a timing...

Many share investors try to time their purchases and sales. “Now is a good time to buy”, they’ll say. Or, “The market’s about to plunge. Get out while the going’s good. “Sometimes they’re right.

“Some (market timers) win big – but they lose big, too, ”says American research analyst Ernie Ankrim.

“Unfortunately, the public often only hears about the upside of a market timer’s performance... As money managers gain experience, they give up on timing.”

The fact is that nobody can accurately predict share market performance. Those who try often regret it.

An example: If Joe invested in the US share market (actually, an S&P500 index fund) in the ten years ending May 2002, his return would have been 10% a year, according to Bloomberg.

But if he had been in and out of the market, and happened to miss just the five best-performing days – that’s only five out of more than 2500 trading days – his return would have dropped considerably, to 7.5% a year. If he had missed the 20 best days, it would be just 3%.

And if he had missed the 30 best days – and we’re still talking just 30 out of 2500 – his return would be a pathetic 0.8% a year.

Nobody, of course, would be unlucky enough to miss all the good days. But those who are in and out of the market will almost certainly miss some booms, which are notoriously difficult to foresee.

A counter argument is that, if Joe is in and out of the market, he will also miss some of the particularly bad days.

Over the long term, though, there are more good days than bad.

Other research shows that, if you’re investing for the long term, it’s not worth worrying too much about when you buy.

Buying or selling on the worst day of the year doesn’t make nearly as much difference as most people would imagine.

Suzy invested $5000 a year in the New Zealand share market, over the last 30 years. The total money invested was $150,000.

If she had extraordinarily bad luck, and each year she bought on the day when prices were at their highest, at the end of the 30 years she would have about $650,000 worth of shares.

If she had extraordinarily good luck, and always bought when prices were at their lowest, how much would she have at the end of the 30 years?

When groups are asked this question, everyone guesses too high. The answer is around $850,000.

Given that we don’t know, at the time, when the market has hit a peak or trough, we’re best to simply buy or sell shares or share fund units when it suits us.

Holm Truths Crossword Solution

W		P	A	T	I	E	N	C	E		C	O
I	T		J	I	N	X				M	A	D
N	O		A			T		R		A	R	E
	P	E	R	F	O	R	M	A	N	C	E	
R				I		A		I			L	
U	P		P	S		O		N		Y	E	S
T	R	E	A	S	U	R	E	C	H	E	S	T
H	E	R		U		D		O	E		S	O
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