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Financial Services

If you chase...
you're likely to get nowhere!

Snapshot

Investment performance statements are being mailed out over the coming weeks and it's not surprising some investors are hesitant to be reminded of their portfolio balance. After all, who hasn't heard a friend or colleague remark "What a year! How bad is my investment portfolio looking!"

When the share market produces a negative return (and 2008 was the worst return Australian investors have had to face), a common response is to consider moving out of shares into something less risky – maybe cash or fixed interest. After all, cash and fixed interest produced great returns last year. STOP!!!!!! You are falling into the trap of becoming a 'chaser' and potentially reducing your wealth. So what is a chaser and what difference does it make to your wealth if you're a chaser compared to an investor who simply sits tight?

Some investors constantly move their capital from one investment class to another, looking for the category that will make the most profit in the next 12 months. We call these investors 'chasers' because they are always chasing after good short term performance instead of committing to a sound, long term investment strategy.

The classic mistake the chaser makes is to chase last year's big investment class in the hope that it will be just as big or bigger this year. Sometimes chasing works, but often it does not.

The table on the next page tells the chaser's sad story – it shows the performance of the different asset classes over the 22 years from 1987 to 2008. The best performing investment class each year is highlighted.

- Notice 1987 was a terrible year for Australian shares, but a great year for bonds. Typically, the chasers shifted to bonds in 1988...
- ...unfortunately for the chasers, Australian shares bounced back in 1988, while the return for bonds dropped by half, so...
- ...back to Australian shares they flocked in 1989. But oops! While Australian shares did quite well that year, international shares did so much better so...
- ...they chased international shares in 1990 – an asset class that fell by 15% that year. Ouch!

Snapshot

The best investment category often varies from year to year. There can be a high price to pay for chasing. Just how high a cost?

Year to 31 Dec	Aust. shares %	Aust. listed property %	Internatl. shares %	Aust. bonds %	Cash %
1987	-8	6	8	19	15
1988	18	16	5	9	13
1989	17	2	27	15	18
1990	-18	9	-15	19	16
1991	34	20	21	25	11
1992	-2	7	5	10	7
1993	45	30	25	16	5
1994	-9	-6	-8	-5	5
1995	20	13	27	19	8
1996	15	14	7	12	8
1997	12	20	42	12	6
1998	12	18	33	10	5
1999	16	-5	17	-1	5
2000	4	18	3	12	6
2001	10	15	-9	5	5
2002	-8	12	-27	9	5
2003	16	9	0	3	5
2004	28	32	11	7	6
2005	21	13	18	6	6
2006	25	34	12	3	6
2007	16	-8	-3	3	7
2008	-40	-54	-25	15	8

Source: July 2009 Perpetual, Datastream

Take the case of Julie and Peter. They both invested $100,000 at the start of 1987. Julie invested her money in a Balanced Fund. She kept her investment in that fund until December 2008 and her investment grew at an average rate of 8.7% per year. Peter invested his money in an Australian Share Fund but throughout the 22 years kept switching his investment to the asset class that had been the best performing asset class in the previous year. Compare the difference in the value of the two investments after 22 years. Peter's investment was worth $374,830 whilst Julie's investment was worth $626,686 an EXTRA $251,856.

The moral of the story: Have a plan and stick to it!

Discipline is the essence of successful investing. You need to define your investment goals, know the level of risk you can happily live with, diversify your investment to help balance the ups and downs that happen from year to year, and think long term for optimum results. That does not mean that you must never change your investment mix – you should review your investment portfolio every year and adjust the balance of your portfolio if necessary – but chasing after the "winning" investment category every year is usually a recipe for disaster.

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