

# “The alternatives”

“Cash is safe but it isn’t king” Sydney Morning Herald, October 26, 2008

What are the alternatives to riding out the current bear market? With the availability of a government guarantee on many cash options is there any downside in a shift to cash? We look at the pros and cons of cashing out, and what sort of role cash can play in a balanced portfolio. Either way, we conclude with one question: “What are you investing for?”

## HEADING FOR THE EXIT?

Cash can look very appealing in times of increased volatility. The government guarantee does offer some opportunities on many cash deposits. You can now choose relatively high-yielding term deposits and cash accounts, while reducing your concerns about the institution offering the product.

While this safety net may relieve your anxiety and help you sleep better at night, it’s important to remember that cash is best used as part of a bigger plan, rather than your whole investment strategy.

## CASH: PART OF A PORTFOLIO, NOT A COMPLETE SOLUTION

Senior Investment Strategist at Advance Asset Management, Felix Stephen, says that cash is an integral component of every balanced portfolio. “Having a cash reserve means you have easy access to a portion of your money, gives you some security and is an ideal parking place while you assess other investment opportunities,” he said. “It is also generally recommended that people who need access to cash in the short term, such as retirees, should keep one to two years worth of income in cash because they don’t have the timeframe to ride out any market bumps.”

Returns for 20 years to August 2008 by asset class

Year to 31 August	Australian Cash %	Australian Fixed Interest %	Internat'l Fixed Interest %	Australian Shares %	Internat'l Shares %	Australian Property Securities %
1988	12.43	15.58	7.17	-24.22	-21.35	-13.38
1989	16.73	8.63	10.69	18.79	34.22	10.08
1990	17.92	15.25	3.28	-9.75	-14.79	11.27
1991	12.57	22.46	14.28	7.67	13.04	3.28
1992	8.25	18.07	12.21	4.23	12.92	17.28
1993	5.77	17.99	15.59	31.85	30.67	31.47
1994	4.96	-2.23	-1.09	11.94	-1.84	-4.51
1995	7.50	11.66	11.65	4.75	7.56	7.77
1996	7.76	12.54	8.00	11.06	7.61	10.96
1997	6.24	13.04	10.26	18.96	32.34	17.49
1998	5.18	8.21	11.84	-0.64	33.64	15.04
1999	5.01	4.65	1.12	23.34	19.91	9.66
2000	5.78	5.82	4.40	14.38	25.11	7.26
2001	5.91	10.44	8.50	2.28	-17.73	16.21
2002	4.63	5.16	6.38	-1.15	-20.62	9.71
2003	4.89	6.59	3.58	8.67	-5.12	10.88
2004	5.47	5.16	4.28	15.96	6.46	24.24
2005	5.67	7.19	6.16	28.89	11.58	17.62
2006	5.81	3.27	-0.03	20.19	14.43	21.02
2007	6.48	4.39	2.33	27.86	10.33	21.89
2008	7.64	6.95	4.87	-13.12	-16.47	-35.34

### Definitions

Cash Australian:	USB Warburg Bill Index
Shares – Australian:	All Ordinaries Accumulation Index
Shares – International:	MSCI World US\$ – Total Return Index \$(Unhedged)
Property:	S&P/ASX 200 Property Accumulation
Fixed Interest – Australian:	UBS Warburg Composite Bond – All Maturities Index
Fixed Interest – International:	JP Morgan Global Traded Local Currency
CPI:	on 'All Groups CPI' – ABS

### Legend

Lowest return

Highest return

Source: Iress, Data Stream and St George Investment Solutions

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## IT'S NOT ABOUT NOW

If you are investing with a focus on the future, rather than on short-term capital preservation, you need to consider a few things before you 'cash out' or tilt your portfolio too heavily away from shares, property and alternative assets.

The chart on the previous page shows how different asset classes have performed over the past 20 years. Cash has only outperformed other asset classes twice during this period.

You should also keep in mind that:

- cash investments don't offer the tax benefits of shares, which can offer capital gains tax discounting and dividend imputation.
- shares can also offer higher income levels than cash investments.

Felix believes that "Shares now offer good value when you take into account their potential for growth," he said. "History shows that if you can hang on, you'll more than likely get the value of your investment back. By 'cashing out' you turn your paper loss into a real loss. Markets often bounce after a crisis, quickly recouping a significant portion of the losses. By selling out you may miss this bounce."

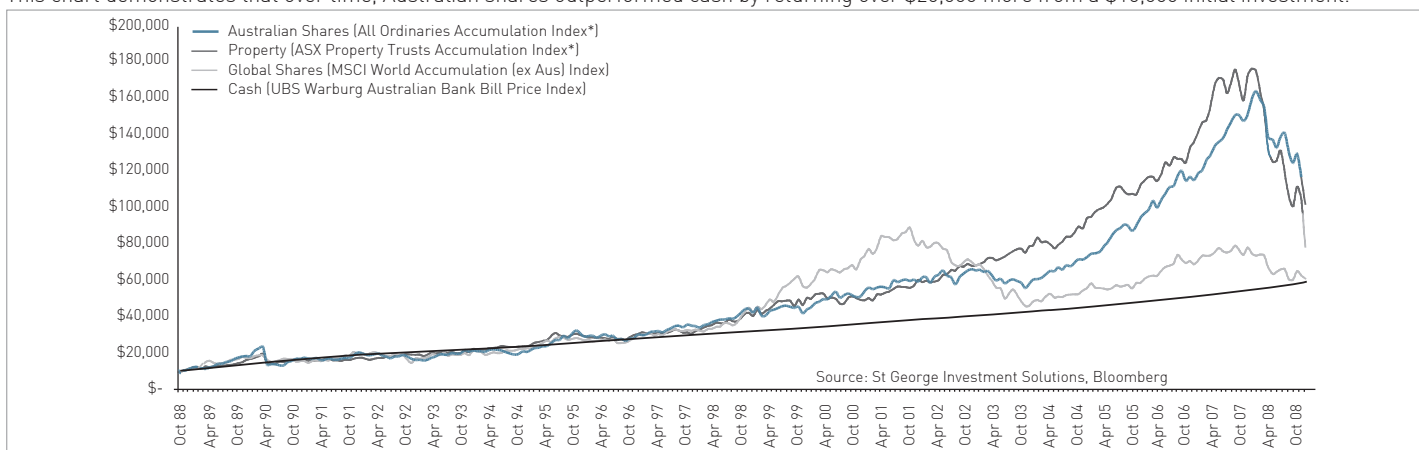
## IT IS ABOUT DIVERSIFICATION

Diversification helps to spread the risk in a portfolio, so that if one sector takes a hit, it won't have a significant impact on the rest of your investments. For example, say you have a diversified portfolio which includes shares in both the hospitality and retail sectors, and an investment property. As a few economies head towards a recession, it follows that less people will be able to afford to go on a holiday, so the value of the hospitality shares may fall, and property values may also be subdued as demand drops.

However everyone still needs to buy life's essentials, so the retail sector, especially the supermarket shares, will be more resilient to the downturn.

## ASSET CLASS PERFORMANCE OVER 20 YEARS

This chart demonstrates that over time, Australian shares outperformed cash by returning over \$20,000 more from a \$10,000 initial investment.



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At some point in the future, these dynamics will change – falling interest rates will stimulate the property market and economic security will support the tourism industry – and because you are diversified across several asset classes, sectors and companies, you will have benefited during both cycles.

## COMPARISON OF ASSET SECTOR RETURNS

The chart on the right illustrates the potential returns available from the various asset classes. Whilst investing in shares (Blue line) has the potential for higher investment returns, you will notice that these roads to fortune have experienced many more ups and downs compared with saving in a cash account (Black line).

## SO, WHAT ARE YOU INVESTING FOR?

How do you resist the urge to jump ship and direct your investments into an apparently safe harbour? The secret is to focus less on the market's short-term waves and more on your long-term needs.

If the recent falls means your portfolio is no longer able to meet your financial objectives – such as providing a retirement income or building wealth to pass on to your family – it makes sense to review your portfolio and look at 'the alternatives' with your adviser.

If, however, you have a long-term time horizon and can handle current levels of volatility, or have additional cash to invest, now may well be the time to take advantage of cheap asset prices and invest more money!

In the end, the choice of asset classes and the mix of investments within your portfolio is entirely personal and depends less on market movements and more on what you are aiming to achieve with your investment strategy.

**Only a financial adviser can provide you with tailored solutions to meet your individual situation and objectives.**

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