focus

Successful long term investing

Successful long term investment is not just about buying low and selling high. Stock markets rise and fall, and share prices are vulnerable to everything from political news flow to the weather. Trying to find your way around – particularly during times of high volatility and uncertainty – can feel like negotiating a minefield.

So how can we make sense of such a confusing world? In this focus we go back to basics – stock markets may rise and fall, but the rules of sensible investment remain constant.

Diversify

Diversification means spreading the risk of investing across a mixture of asset classes, industry sectors and areas of the world. If you put all your money into a single asset class, sector or company, your portfolio is very exposed and performance is likely to be volatile – whereas, if you mix it up, when one asset is going down, chances are another asset could be going up and will help compensate. Put simply, don't put all your eggs in one basket.

How does diversifying help?

Recent events in world economies and stock markets may seem extraordinary but they may still follow a pattern that has occurred before. By understanding this, it is easier to put current events in context and get an overview of the most appropriate investment strategy.

At any time, an economy is either expanding or contracting. Economic cycles have clear characteristics – and certain asset classes tend to do well at different stages, as the diagram shows below.

Scenario	Inflation	Deflation	Economic Recession
Strategy	Index linked bonds UK Equities Global Equities Commodities Property	Government bonds Corporate bonds Cash	Government Bonds Cash

The Roberts Partnership

Diversify

What can be learnt from the past?

Stock market cycles tend to be three to nine months ahead of economic cycles. So if economic recovery is expected in a year's time, it may be reflected in share prices in just three months time.

Different asset classes and industry sectors do well at different stages of the cycle. Investors who diversify across different equities, bonds, property, cash and other assets, may achieve the best balance of risk and return over the long term.

Given the contraction in market cycles, it may be prudent to consider multi-asset funds, where the underlying asset allocation decisions are taken by the fund managers on a daily basis.

Invest for the long term

Trying to time your investments so you buy right at the bottom and sell right at the top is near impossible. Similarly, trying to make short term profits by turning over investments quickly will get expensive and carries a high risk. Instead, target your portfolio at quality funds and then allow them the time and space they need to grow.

As we have seen the economy follows cycles. 'Recession' is commonly defined as two consecutive quarters of negative growth (in the Gross Domestic Product). The length of a recession in the average lifetime of a portfolio is not long. Even if you take into account the negative behaviour of markets both in anticipation of and in the aftermath of such data, it is still only a short time compared with the 20 plus years over which we plan for our retirements.

If your portfolio meets your personal criteria and is well diversified, a recession should not cause you to change plans. Sometimes doing nothing is best.

Buy what's right for you

That previous sentence is crucial "If **your** portfolio meets **your** personal criteria and is well diversified, a recession should not cause you to change plans." It's all about you. Just because an investment works well for somebody else does not mean it is right for you. Consider your own situation – your future liabilities, your investment goals and, importantly, your appetite for risk – and then make your decision.

Your attitude during negative periods is as important as your portfolio's structure. Economies can't keep growing indefinitely, and recessions are likely to happen every few years. Successful investors tend to be pragmatic and realistic. They invest for the long term and expect that whilst there will be good times, there will also be some bad. A short-term downturn should not be seen as reason to panic.

Don’t follow the herd

Many investors became caught up by the euphoria which surrounded the dot-com boom of the late 1990's simply because everyone else was and they did not want to miss out. Consequently, they bought shares in companies that promised much and delivered little or nothing.

Investor behaviour is driven by sentiment. When markets are strong and share prices are high, flows into equity funds also tend to rise. But when markets are low and share prices offer better value, there is less money invested. Therefore many investments are made at the top of the market, while investors frequently miss out on the opportunity to invest when share prices are low. The result can be damaging for long-term returns.

“Profit from folly rather than participate in it” Warren Buffet, CEO Berkshire Hatherway Inc.

It is hard to turn against the flow but always take a step back and think not just about what you are buying, but why.

Don’t believe everything you read

Headlines on TV and in the finance sections of newspapers can be just as misleading without investigation as they are in celebrity news and sport. Headlines that scream “worst figures for 30 years” confirm what we have just been through but do not necessarily reflect the prospects for tomorrow. What they do, however, is fan the flames of investor uncertainty.

Make sure you keep a clear head, remain focused on your objectives and take advice from a qualified professional to ensure you are making the most of your investment portfolio.

Review your portfolio regularly

Your portfolio has been set up to meet your objectives based on your needs. However, over time, your needs and circumstance can change. The markets can also change, which may mean you need to alter your investments or it may even change your attitude to risk. It is therefore important that you take the time to review it regularly and make sure it stays on track.

If an investment has risen substantially, take another look

It’s wonderful if a holding has worked for you, but you don’t have to feel grateful. You should look at every existing investment with the same clear headed objectivity as you did before you bought it.

Short term sentiment in stock markets can drive values artificially high, in which case, you may want to cash in while you can. Don’t get greedy – you should never be ashamed to take a profit.

Know when to say goodbye

If a holding has performed particularly badly relative to its peers, you need to consider cutting your losses and selling it altogether. It might be better to sell out and reinvest the proceeds into a quality alternative than to sit around hoping to recoup your loss.

T. 0161 835 2266
W. www.robpar.co.uk

Invest tax efficiently

Collective investments (investment funds) are an efficient way of investing into the various asset classes. The professional fund manager is able to buy and sell holdings within the fund without incurring capital gains tax. You, as the investor in the fund, only pay tax on any gains (outside your yearly allowances) when you sell the investment. Income tax may also be payable on dividends generated.

And finally, when you are thinking about long term investments, you should always remember to take advantage of the tax breaks available to you. ISAs and pension should be a priority because they both have attractive tax breaks. These allow you to optimise investment/saving returns even before you take on any risk.

ISAs allow you to get at your money at any time, so they can be used for medium as well as long-term investments. Remember that all income and growth taken from your ISA is tax free.

Pensions can be used for long term savings you don't want to touch until retirement. They offer a unique combination of tax breaks, including tax relief on contributions, tax efficient growth and tax free withdrawal of up to 25% of the fund value at retirement.

A simplified example, a higher-rate tax payer pays £8,000 into a pension which results in an investment of £10,000 as a result of 20% basic tax relief being available at source. A further 20% tax relief is available through their tax return meaning that the net outlay is £6,000. At retirement, 25% (in this example £2,500) of the fund can be taken tax free. This means that even if the £6,000 did not grow over the period, you could take out the tax free lump sum at retirement and still leave an amount greater than your original investment (£7,500).

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