Markets a challenge for investors

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Danger zones ... with warning signs at every turn, fear is influencing investors' choices. *Illustration: Nic Walker*

After four major crises in the past decade, concerns are mounting over the best way to invest for retirement.

If you want an illustration of how difficult the environment has become for share investors, consider the fact that US stocks have now underperformed bonds not just in the short term but in the past 30 years, which is something they haven't done in any other 30-year period since the start of the American Civil War. That's right - since 1861.

The global chief investment officer for asset management and private banking at Credit Suisse, Stefan Keitel, who visited Australia this month, says that has placed a question mark against the equities culture in countries such as the US and Australia, which have a tradition of share ownership.

''In equity-friendly regions - as, for example, the US - people now have far more doubts whether they really should go for pure equity investing when it comes to retirement planning,'' the Zurich-based Keitel says.

''If you look back at the behaviour of US investors, their whole retirement was planned on equity investing. After having experienced four major crises over the last decade, now the doubts are rising if that's the right strategy.''

Australians have also had a love affair with equities. In 2004, 55 per cent of the population owned shares, according to the annual share ownership survey by the Australian Securities Exchange, putting them on a par with Americans. That rate slid to 36per cent amid the global financial crisis in 2008 but recovered to 43 per cent last year. This year's InvestSMART Funds Flow Survey, the online discount fund brokers owned by Fairfax Media, found that the huge volatility in global sharemarkets had indeed sent many local investors to the sidelines or into more conservative asset classes (see story below).

Asked whether the Wharton School study of the long-term return from shares versus bonds refuted portfolio theory that there's an ''equities risk premium'' - extra return for taking on a riskier asset - Keitel says the result is ''pretty interesting'' but not surprising.

''Especially the last 11 years have been anything but good for the equity investor, given the different crises scenarios we have already had,'' he says. ''[But] what has been now the result for the past 10, 11 and maybe, on average, the last 30 years must not necessarily be the result for the next 30 years.''

In other words, as Australian investors are reminded in every product disclosure statement, past performance is no predictor of future performance.

''We think the phase of outperformance of bonds against equities will definitely come to an end,'' Keitel says. ''It will not be a sharp trend reversal … equity markets will stay volatile but I think when you compare these two asset classes, given the valuations behind them, we think that equity markets are better underpinned.

''So portfolio theory will come back and also the risk premium will come back. But … it will take time - mean reversion always takes time.''

Keitel used the word fear to describe the attitude of some investors to equities these days, amid enormous volatility in sharemarkets as stock prices plummet at the first hint of bad news and soar in response to any reassurance.

''I think we are living in a more trading-oriented world and maybe the capital markets in general have become a bit more unserious, '' Keitel says.

Just as markets focused too much on the negative in July, August and September, they were perhaps too positive during the counter-rally, he says. That in turn preceded another slump as Greece prevaricated over its debt crisis.

''Investing disciplines are much more short-term oriented than they have been in the past,'' Keitel says, making markets more challenging places for smaller investors. ''It's getting more and more complex [for the ordinary investor] because the cycles are getting more and more short-lived,'' he says. ''That complexity, I think, is of course for many investor types not a good thing and, of course, also limits down the willingness to invest in these markets.''

But from Credit Suisse's point of view, that only means there's a strong need for guidance from advisers such as itself, he says. "It's different if you're in a market cycle like 1982 to 2000, where everybody could make money without having any intellectual competence."

Keitel expects "the next weeks, months and years will be anything but boring. It will stay extremely challenging in the capital markets and it will also stay challenging when we talk about … the equities side."

Key risks include below-trend economic growth - but not recession - in major nations, inflation in nations such as China and any escalation of the sovereign debt crisis.

On the positive side, there's what he calls "the experience factor". "All central bankers and politicians now are pretty aware what contagion means," he says.

Markets have already priced in most of the apparent risks. Also, investors can't afford to stay in cash forever, especially with low or falling interest rates.

"So despite a broad bundle of risks, we also have a broad bundle of supporting elements," Keitel says.

What that means in practice depends on an investor's risk profile, he says.

People with long-term horizons might take setbacks as buying opportunities, while those with shorter-term horizons, who don't have time to recover from losses, could use rebound rallies to move more money to the sideline.

There's numbers in safety

Do Australian investors, like Americans, increasingly fear equities?

The annual InvestSMART Funds Flow Survey released last week found that sharemarket volatility has sent many Australian investors onto the sidelines or into more conservative asset classes in the past two years.

The survey of 1540 "self-directed" investors using the online discount fund broker's service found there was a 19 per cent decrease in share holdings between 2009 and this year but also a 35 per cent fall in cash holdings. Fixed interest was a significant benefactor (up 85 per cent), along with property holdings (up 37 per cent).

There was a 110 per cent increase on last year in the number of respondents who rated the current market as bearish.

Another indicator might be how much money is being kept in cash by self-managed super fund trustees.

Researcher Investment Trends, as part of its annual SMSF Investor Report, found that total cash held by SMSFs grew by $40 billion between the publication of its reports in May 2009 and this year, an increase of 54 per cent.

Key points

❏ US stocks have now underperformed bonds over the long term.

❏ Credit Suisse is expecting the "equities premium" to return, however.

❏ Continued market volatility is also scaring off some investors.

❏ Volatility is expected to remain for some time.

❏ Investment cycles are increasingly short-lived.