GUARDIAN INVESTMENTS

September 2021

It's October and with grand finals done and won, the countdown to summer begins. Despite ongoing lockdowns, rising vaccination rates are paving the way for the re-opening of borders and business.

September was a mixed bag on the economic front. After reaching record highs in August, global share markets stumbled in late September. There are concerns about rising inflation and bond yields if the US Federal Reserve begins tapering their bond purchases later this year as expected. Markets also grappled with rising COVID cases in a vaccinated population, the potential collapse of the Chinese property developer Evergrande, global supply chain blocks and rising oil prices (oil was up 10% in the quarter and is at a 3yr high).

In Australia, consumer confidence is growing in response to State and Federal governments revealing their re-opening plans. The ANZ/Roy Morgan consumer confidence rating rose over the last three weeks of September to a 10-week high of 103.7. Prior to that, retail trade fell 1.7% in August and 0.7% over the year. And while the unemployment rate fell from 4.6% to 4.5% in August, participation and hours worked all fell. This reflects the large numbers of Australians who have been stood down due to COVID but not actively seeking work. In contrast there is a strong expectation that working hours will increase as summer approaches, again feeding inflation expectations.

Despite some of the above concerns, policy setting remain very accommodative globally. Central banks will want to be sure that growth is settling 'above trend' before any tightening occurs. We think it will be at least a medium term issue.

Returns for the first quarter (3 months) are below:
All Ordinaries: 7629, up 44 points or +0.58%;
Listed Property Accumulation Index 63366, up 2575 or +4.2%;
90 Day Bank Bills 0.03%, steady
AUD vs U.S. Dollar $0.7206, down 2.6cents or 3.5%;
UK FTSE 100, 7086 points, up 70 points or 1.0%;
Dow Jones Industrial Avg. 33843 points, down 402 points or 1.2%

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WHAT'S UP WITH INFLATION?

Fears of a resurgence in inflation has been the big topic of conversation among bond and sharemarket commentators lately, which may come as a surprise to many given that our rate of inflation is just 1.1 per cent. Yet despite market rumblings, the Reserve Bank appears quite comfortable about the outlook.

Inflation is a symptom of rising consumer prices, measured in Australia by the Consumer Price Index (CPI). The RBA has an inflation target of 2-3 per cent a year, which it regards as a level to achieve its goals of price stability, full employment and prosperity for Australia.

Currently the RBA expects inflation to be 1.5 per cent this year in Australia, rising to 2 per cent by mid-2023.[i] Until the inflation rate returns to the 2-3 per cent mark, the RBA has said it will not lift the cash rate.

US inflation rising

The situation is a little different overseas where inflation has spiked higher. For instance, US inflation shot up to an annual rate of 5 per cent in May, the fastest pace since 2008, up from 4.2 per cent in April.[ii] As experienced investors would be aware, markets hate surprises. So with inflation rising faster than anticipated, share and bond markets are on edge.

But just like the RBA, the Federal Reserve views this spike as temporary, pointing to its being a natural reaction after the fall in prices last year during the worst days of the COVID crisis. In addition, companies underestimated demand for their goods during the pandemic and as a result there are now bottlenecks in supply that are putting upward pressure on prices.

The central banks believe that once economies get over the kickstart from all the government stimulation, inflation will fall back into line. After all, most world economies went backwards last year, so any growth should be viewed as a good thing and more than likely a temporary event.

But markets are not convinced.

Inflation and wages

Market pundits argue that if businesses must pay more for materials and running costs such as electricity then these increases will most likely be passed on to the consumer.

That's all very well if your wages also rise, but if your income remains static then your standard of living will go backwards as you will have to spend more money to buy the same goods.

This then becomes a vicious circle. If the cost of living rises, then you will seek higher wages; this will the put further pressure on the costs for businesses. They will then have to increase their prices further to cover the higher wages bill. Some companies may react by reducing staff levels which will lead to higher unemployment.

Impact on investment

Inflation can also have a negative impact on investors because it reduces their real rate of return. That is, the gross return on an investment minus the rate of inflation.

Rising prices and interest rates also impact company profits. With companies facing higher costs, the outlook for corporate earnings growth comes under pressure.

But not all stocks are affected the same. Companies that produce food and other essentials are not as sensitive to inflation because we all need to eat. Mining companies also benefit from rising prices for the commodities they produce. Whereas high growth stocks like technology companies traditionally suffer from rising interest rates.

Markets current fear is that central banks will tighten monetary policy faster than expected. Interest rates will rise, money will tighten, and this will fuel higher inflation.

Bond market fallout

Expectations of higher inflation has already seen the bond market react, with the 10-year bond yield in both Australia and the US on the rise since October last year.

If yields rise, then the value of bonds actually fall. This is particularly concerning for fixed income investors. Not only are you faced with the prospect of capital losses because the price of your existing bond holdings generally falls when rates rise, but the purchasing power of your income will also be reduced as inflation takes its toll. Investments in inflation-linked bonds should fare better in an inflationary environment.

Inflation is part of the economic cycle. Keeping it under control is the key to a well-run economy and that is where central banks play their role.

Call us if you would like to discuss how an uptick in inflation may be impacting your overall investment strategy.

i https://www.rba.gov.au/media-releases/2021/mr-21-09.html

ii https://tradingeconomics.com/united-states/inflation-cpi

Investing lessons FROM THE pandemic

When the coronavirus pandemic hit financial markets in March 2020, almost 40 per cent was wiped off the value of shares in less than a month.[i] Understandably, many investors hit the panic button and switched to cash or withdrew savings from superannuation.

With the benefit of hindsight, some people may be regretting acting in haste.

As it happened, shares rebounded faster than anyone dared predict. Australian shares rose 28 per cent in the year to June 2021 while global shares rose 37 per cent. Balanced growth super funds returned 18 per cent for the year, their best performance in 24 years.[ii]

While every financial crisis is different, some investment rules are timeless. So, what are the lessons of the last 18 months?

Lesson #1 Ignore the noise

When markets suffer a major fall as they did last year, the sound can be deafening. From headlines screaming bloodbath, to friends comparing the fall in their super account balance and their dashed retirement hopes.

Yet as we have seen, markets and market sentiment can swing quickly. That's because on any given day markets don't just reflect economic fundamentals but the collective mood swings of all the buyers and sellers. In the long run though, the underlying value of investments generally outweighs short-term price fluctuations.

One of the key lessons of the past 18 months is that ignoring the noisy doomsayers and focussing on long-term investing is better for your wealth.

Lesson #2 Stay diversified

Another lesson is the importance of diversification. By spreading your money across and within asset classes you can minimise the risk of one bad investment or short-term fall in one asset class wiping out your savings.

Diversification also helps smooth out your returns in the long run. For example, in the year to June 2020, Australian shares and listed property fell sharply, but positive returns from bonds and cash acted as a buffer reducing the overall loss of balanced growth super funds to 0.5%.

The following 12 months to June 2021 shares and property bounced back strongly, taking returns of balanced growth super funds to 18 per cent. But investors who switched to cash at the depths of the market despair in March last year would have gone backwards after fees and tax.

More importantly, over the past 10 years balanced growth funds have returned 8.6 per cent per year on average after tax and investment fees.[ii]

The mix of investments you choose will depend on your age and tolerance for risk. The younger you are, the more you can afford to have in more aggressive assets that carry a higher level of risk, such as shares and property to grow your wealth over the long term. But even retirees can benefit from having some of their savings in growth assets to help replenish their nest egg even as they withdraw income.

Lesson #3 Stay the course

The Holy Grail of investing is to buy at the bottom of the market and sell when it peaks. If only it were that easy. Even the most experienced fund managers acknowledge that investors with a balanced portfolio should expect a negative return one year in every five or so.

Even if you had seen the writing on the wall in February 2020 and switched to cash, it's unlikely you would have switched back into shares in time to catch the full benefit of the upswing that followed.

Timing the market on the way in and the way out is extremely difficult, if not impossible.

Looking ahead

Every new generation of investors has a pivotal experience where lessons are learned. For older investors, it may have been the crash of '87, the tech wreck of the early 2000s or the global financial crisis. For younger investors and some older ones too, the coronavirus pandemic will be a defining moment in their investing journey.

By choosing an asset allocation that aligns with your age and risk tolerance then staying the course, you can sail through the market highs and lows with your sights firmly set on your investment horizon. Of course, that doesn't mean you shouldn't make adjustments or take advantage of opportunities along the way.

We're here to guide you through the highs and lows of investing, so give us a call if you would like to discuss your investment strategy.

i https://www.forbes.com/sites/lizfrazierpeck/2021/02/11/the-coronavirus-crash-of-2020-and-the-investing-lesson-it-taught-us/?sh=241a03a46cfc

ii https://www.chantwest.com.au/resources/super-funds-post-a-stunning-gain

DECISION MAKING
YOUR WAY TO THE BEST OUTCOME

Throughout our lives, making a decision is something we do thousands of times a day. Our first thought occurs as soon as we wake, and our final thought when we drift off to sleep. Researchers have found on average, that most people will have approximately 6,200 thoughts per day.[i]

Having so many thoughts requires us to make thousands of decisions. Whilst majority of these decisions are simple and will have no significant consequence, there are times when more difficult and complex decisions will need to be made and require creative thinking techniques and a deeper thought process to ensure a more successful outcome.

Deep thinking vs shallow thinking

Two types of methods can be used when it comes to decision-making and while neither is right nor wrong, it's important to understand the difference between the two and choose the method that works best for you and the situation. After all, if we all thought the same way, life would be pretty boring right?

Deep thinking requires effort and mindfulness and someone who is considered a deep thinker will usually look at the whole chain of events throughout this thought process. They will explore different pathways to reach different outcomes and have a greater understanding of the consequences based on that specific decision.

Contrary to deep thinking is shallow thinking, and these decisions are instinct-driven – they are made immediately. This type of thinker is decisive and won't necessarily spend time exploring different pathways to reach an outcome or consider the consequences of their decisions as much as a deep thinker would.

Can you learn to become a deep thinker?

Some may say, with so much technology and information on hand, shallow thinking is now far outweighing the deep thought process and we are losing the ability use these creative thinking skills to make certain choices. Our attention span is limited; we are distracted easily therefore, our thought process is constantly being interrupted, meaning we spend less time thinking about the outcomes of the choices we are making.

There are several steps you can implement to learn how to become a deep thinker. Firstly, you must fully understand the situation in detail – what is being asked and what impact it will have – only then, can you spend time creating a constructive environment to make decisions. In creating a constructive environment, you will need to determine whether other people should be included in this process.

By including others, you have the opportunity to take into account other people's ideas. This is a fantastic way to explore ideas that you may not have previously considered and give the process the time and attention it deserves. Once you have reviewed all options, you can determine the risks and impacts of each, then decide what the best outcome is likely to be.

Alternate ways to make decisions

Some decisions won't be as complex or require the same level of creative thinking to make the right choice. Some alternate options could be as simple as – sleep on it. While this may seem like a 'no brainer', this can be one of the most effective ways to make a decision. While you are sleeping, your subconscious is still hard at work.

Talk to friends, relatives, or colleagues whose opinion you value - they can offer a different perspective if you are unsure about your decision.

Schedule a specific time in the day to help you focus – do you do your best thinking in the morning, afternoon, or evening. Remember, to focus completely, you need to remove all distractions during this time - turn off your email notifications and put your phone on silent.

If the decision is work-related, try delegating tasks as this could help reduce stress if work is piling up.

Change your environment – going for a walk or meditating can help you relax which then allows you to free space in your mind and shed new light on the way you think.

No right or wrong

Remember, there is no right or wrong when it comes to making decisions. Whether they are personal or business-focused, by applying some of these methods, you may alleviate stress and reach a better outcome when you next make a decision.

i https://www.newshub.co.nz/home/lifestyle/2020/07/new-study-reveals-just-how-many-thoughts-we-have-each-day.html