TIME TO TAKE A DEEP BREATH

While the global economy is recovering from the 2008 Global Financial Crisis, the recovery has been patchy with unemployment remaining high and government debt increasing. While many commentators are surprised by this recovery profile, it is actually consistent with past recoveries from banking crises.

Academic research suggests that, in the aftermath of a major banking crisis, it takes more than four years for an economy to recovery to its pre-recession peak and even longer for full employment to be restored. One of the main constraints holding back economies is the level of debt, particularly government debt.

Volatility in global financial markets has intensified in recent months reflecting concerns over the outlook in the US and European economies. The downgrade of the US's AAA sovereign credit rating early in August added to concerns about the sustainability of the US debt position. At the same time, economic indicators were showing a slowing in the rate of the recovery, with some raising the possibility of the US slipping back into a recession. Given that the US economy is four times the size of the worlds next biggest, what happens there has implications for all investors.

In addition, there continue to be fears the debt problems in peripheral European economies could spread to their larger neighbours and affect the stability of the banking system. So far measures taken by the European Central Bank have helped to calm the markets.

Nonetheless, markets remain on edge given continued growth and stability concerns, and seem to be exhibiting a lack of confidence in government's abilities to come up with a credible plan to deal with the issues facing the markets.

While the sheer panic of early August appears to have subsided, globally prices of assets such as shares have fallen in value as investors have factored in expected slower economic growth and become risk averse. This has left global equity valuations looking attractive, with some markets trading at valuations lower than at the depths of the Global Financial Crisis.

Throughout the recent crises, monetary policy has been used successfully to stabilise financial markets. While it has done little to stimulate economic growth, it remains the only tool available to rekindle economic growth. As a consequence, global interest rates are likely to remain lower for longer which will keep NZ interest rates down.

So, should investors re-evaluate their exposure to growth assets like shares in these volatile times?

LESSON ONE – HAVE A PLAN

Firstly, it is important to ensure that your portfolio contains enough cash to enable you to 'ride out' these volatile times. Adopting a needs-based approach and having a considered financial plan means that current living needs can be funded without having to sell assets at depressed prices.

Secondly, your financial plan should ensure that you have the right asset mix and appropriate diversification for your risk profile. Portfolios need to be monitored and re-evaluated to ensure that the right asset mix is maintained.

Finally, don't make rash decisions. Good decisions are seldom made when emotions are at their peak.

LESSON TWO – LEARN FROM HISTORY

The most common question we are asked as advisers at times like this is – should I still have part of my portfolio invested in shares?

It is important for investors to remember that shares represent not only an amorphous asset class that rises and falls with the global economy, but also an individual share of a business, and if the underlying business is doing well, the share price must ultimately reflect this, despite global economic uncertainty.

History has consistently demonstrated that global shares are a better store of value than term deposits on an after tax basis.

Furthermore, some of the most spectacular share market gains have occurred as global shares have moved from fairly valued to significantly overvalued. And that situation has frequently occurred during periods of negative real interest rates such as that which prevails now. The best way therefore that a saver can protect themselves is to diversify themselves away from bank deposits. Share returns over the past decade have been poor, but the outlook for the next decade is certainly more positive.

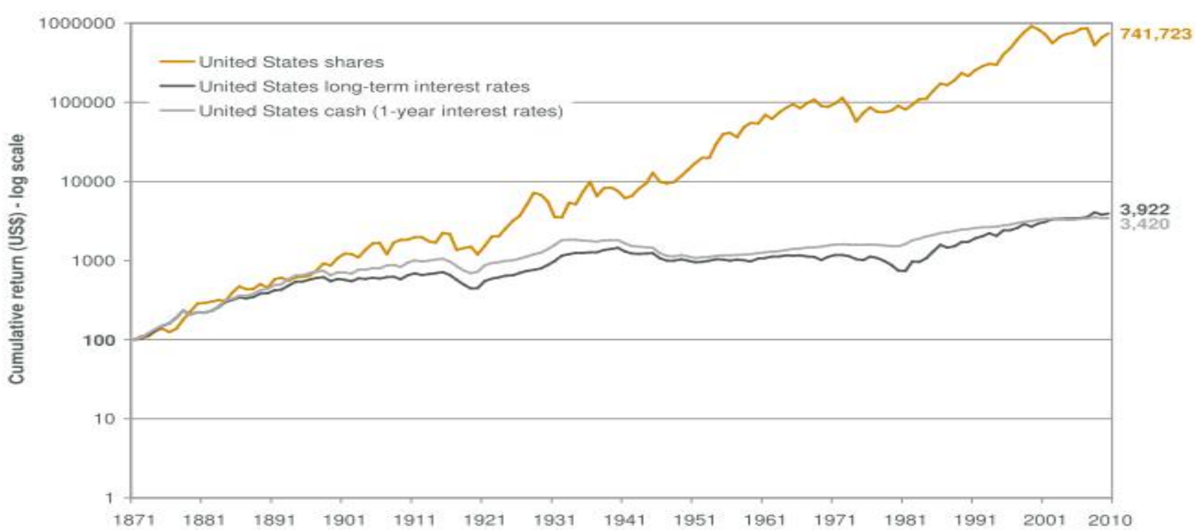
GWM STAFF NEWS

Many of you will have talked to our new Client Service administrators at Botany and Albany. Kirsten Miller joins us from NZ Guardian Trust and brings a wealth of knowledge in trust administration.

Jackie Heswall has joined us in Albany, bringing with her many years of administration experience in the funds management industry.

The newest team member is young Ella Walter, although proud dad Kent can't confirm if she is going to become a financial planner at this stage!

Figure 1. Long-term returns from United States shares compared with government bonds and cash from 1871 to 2010



Source: Robert Shiller; http://www.econ.yale.edu/~shiller/data.htm.