Riding the rollercoaster

Participating in the investment markets is sometimes described as riding a rollercoaster. The more the market swings up and down, the scarier it is. The greatest fear comes from when the portfolio suddenly takes you down a steep decline. What makes the analogy even more apt is the way investment charts are normally presented, with the price bouncing up and down.

The first quarter of the 2011/2012 financial year took this experience to a new level.

Have a look at the following two charts presented here. The first tracks this year's price movements of a basic US share market index: the Standard & Poor's 500 index of larger US companies.

The ride was proceeding along, perhaps a little bumpily, until suddenly large cap stocks suddenly went into a free-fall. After that, the trip was incredibly bumpy both up and down, making it treacherous for any investor who tried to trade out of a downturn or to revisit their investment strategy for reactive reasons, meaning potentially missing out on all of the sudden upswings.

The second chart shows the VIX Index, which simply measures how volatile the S&P 500 is at any given time. The VIX Index is the ticker symbol for the Chicago Board Options Exchange (CBOE) Market Volatility Index and is a popular measurement for implied volatility in the S&P 500.

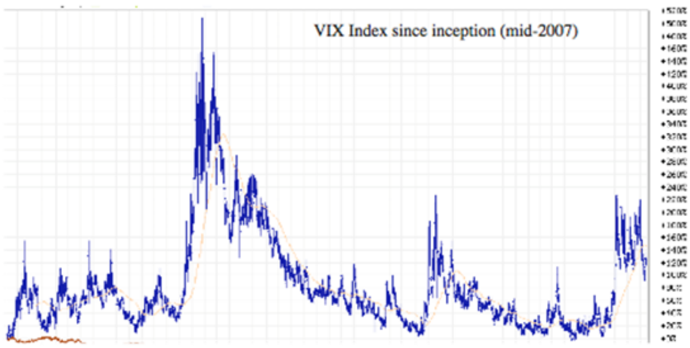
Higher numbers indicate a bumpier ride, and you can see that the September quarter was remarkably more volatile than the March and June quarters of the previous financial year.

How long will our present volatility continue?

Probably not forever; history shows that large groups of investors become fearful, and then calmed a bit, and then become fearful again with surprising regularity.

This next graph shows the movements of the VIX since inception in the summer of 2007; the spikes look almost like a slightly irregular heartbeat, with the big one coming in the last three months of 2008, followed by scary bumps in the rollercoaster in mid- 2010 and the September quarter just ended.

Bloomberg recently reported that the VIX Index had fallen the sharpest it ever has in 19 years, ie. general investor fear calmed down at an extremely rapid rate. This sudden calming was tied in with higher-than-expected corporate profits and constructive news announcements regarding potential solutions for the sovereign debt crisis in Europe.



This graph may not give us a window into the future - the next heartbeat will be unpredictable. But if the past is any indication, the markets will take us through some smooth periods, and then suddenly give us a good scare all over again. This is the nature of the investment markets.

The share market in Australia depicts a similar story, but when looked at over the past decade, you can find the right perspective. See the back of this flyer for the next graph.

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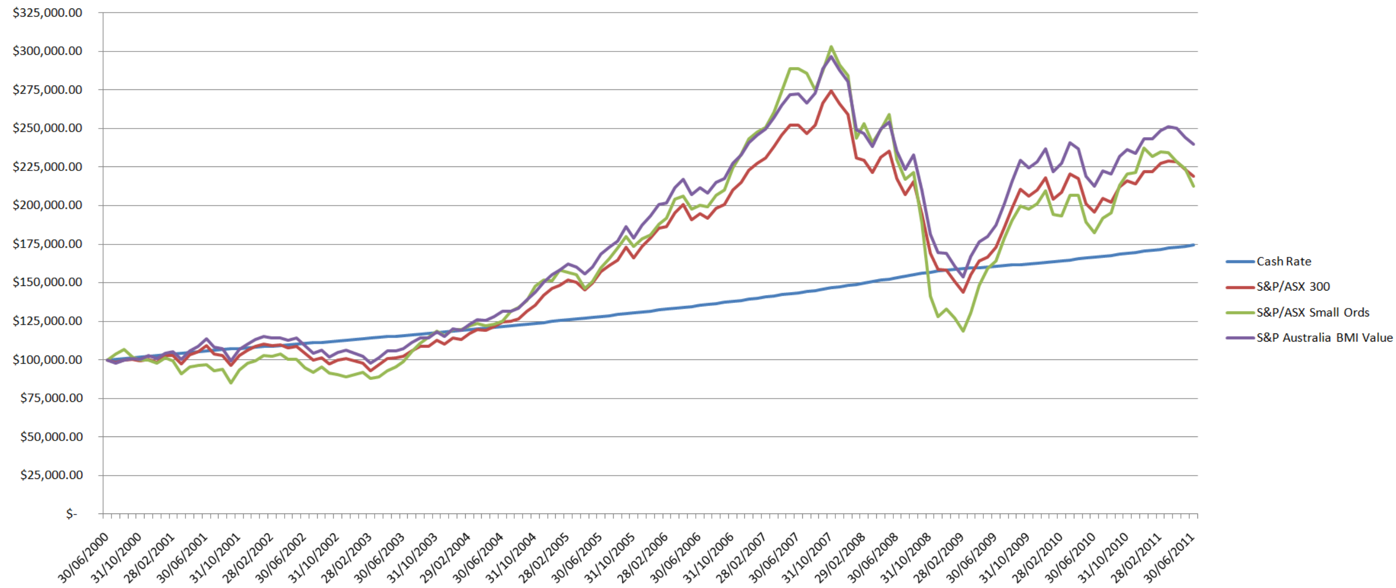

It's important to remember that each investor faces different circumstances in each of their lives and has different sets of priorities, but there is a fundamental objective and that is to actually achieve their objectives.

An adverse decision would be for an investor to alter their strategy at the wrong time or even worse, to sell down their investments to cash. The problem with switching to cash during a volatile period is that the investor may then be stuck in cash, achieving a return that over the medium term won't achieve their objectives. They will be waiting until the market begins to recover before they invest again. This may in turn mean that the investor misses out on substantial growth by not being able to time when to invest back into the market.

If the VIX Index tells us anything, it's that investor confidence is on the same rollercoaster ride that share markets are on. It's why we broadly diversify our investment portfolios and invest for the long term – to protect our clients and to help them achieve their long-term financial and lifestyle objectives.

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