The means for making the future

Influential writer and management consultant Peter Drucker once said: “Objectives are not fate; they are direction. They are not commands; they are commitments. They do not determine the future; they are means … for the making of the future.”

It’s a well-known axiom that prudent financial planning requires identifying your personal financial and lifestyle objectives, and implementing strategies to achieve those objectives over the long term. Remaining committed to those strategies is an important part of this process.

Of course, regular monitoring and review of strategy is equally vital. It ensures that changes to your personal circumstances can be factored in so that no matter what you face in life, you’re always on track toward achieving your objectives.

As volatility appears to continue, and with Europe being a key discussion point when looking at general investor sentiment, let’s take a brief look at the economic context.

Economic context in brief

Global markets continue to be dominated by the European sovereign debt crisis. The lack of confidence and uncertainty have been impacting on sentiment. The impact of this uncertainty may be waning as the possible scenarios are examined and re-examined time and time again.

Overall equity markets have been showing signs of improvement since the September quarter with significant improvements in the December quarter. This has continued into the new year with markets having one of their best starts for decades.

There are positive signs coming from the US with consumer confidence improving and unemployment is falling. Corporate America has addressed many of its problems with corporate balance sheets being in a much healthier state. Alongside the coming presidential elections in the US, there is reason to be somewhat optimistic about this year’s results.

Despite some slowdowns, global economic growth is still dominated by emerging economies. Asia, is still expanding solidly compared to the West. China has continued to exercise strict controls in managing its economy while the Japanese disaster is being overcome with consumer consumption and exports on the increase.

In Australia, our two- or three-speed economy is continuing. Mining investment continued to dominate growth with Western Australia still leading the way. Consumers are saving rather that spending leading to a continued slump in construction and in traditional retailing. The Reserve Bank cut official interest rates twice in the December quarter. Further cuts are likely as a stimulus to the economy should inflationary pressures allow.

Only time will tell whether the current improvement in markets is merely a sizeable bear market rally. Sovereign debt levels still need to be addressed and there is no simple solution.

Investment strategies in times of volatility

When markets and economies are as volatile as they have been, what would be an optimal investment strategy for an investor who is close to retirement, an investor at the height of his or her career and an investor just starting out?

The reality is that there is not all that much difference between those three scenarios. Each investor is facing different circumstances in each of their lives and has different sets of priorities, but there is a fundamental objective that makes these three scenarios the same.

They each want to actually achieve their objectives.

With that in mind, each investor will have a different risk profile according to their circumstance and situation. Where each risk profiles is especially unique is that it must also address how much risk each investor can handle so that they are not tempted to make emotional decisions with their investments.

An adverse decision would be for an investor to alter a strategy at the wrong time or even worse, to sell down investments to cash. Switching to cash during a volatile period may mean being stuck in cash, achieving a return that over the medium term may not assist with achieving objectives.

Waiting until the market begins to recover before investing again 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.

Should you go on the defensive?

As volatility appears to continue, is it advisable to defensively move to a lower risk investment strategy - one that favours cash or fixed interest for example?

The primary issue with this type of methodology is the risk of missing out. We've all seen portfolios go down, as well as recover. History shows us the same. It's the trying to time the recovery that may lead to missing out.

This situation negates the heart of the matter - to achieve one's objectives. It all comes back to only being in cash if it will achieve your objective.

Cash can play a valuable role in a diversified portfolio, but investing in cash should only be done if it supports your long-term objectives. As your circumstances change over time, you may be in a position to reduce the amount of risk you are exposed to by increasing your investment in cash.

Based on your changing risk profile, an amendment to your long-term strategy is therefore made deliberately and keeps you on track to achieve your objectives.

Given high interest savings accounts and term deposits have performed arguably well compared to the market, what value do they hold to an investment strategy?

We do often hear the statement "so I would have been better off if I had invested/stayed in cash."

Comparing cash to equities is like comparing apples and oranges. The question should be: "Why didn't I originally invest more in cash?"

The answer then comes back to the return you needed to achieve your objectives. It also comes back to the risk profile that showed you could withstand the adverse conditions that will always be a part of investing in growth assets and are needed to give you a high enough return over the longer term to achieve your objectives.

Comparing cash performance with the performance of equities is primarily motivated by an emotional reaction to the performance of the market, the media and what we call "the noise". Investment properties have not necessarily fared well either, but the performance of land value would never be compared with the performance of cash. So why are we tempted to compare equities and cash?

In conclusion

Making well-deliberated decisions when setting a strategy to achieve goals in life means committing to that strategy according to the appropriate amount of risk. As goals or circumstances change, your risk profile might change, and adjustments can be made to the strategy accordingly along the way.

Remaining committed to strategy can be the means for making your future.

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