# Oliver's INSIGHTS

20 NOVEMBER 2023 | EDITION 32

## Nine key things for successful investing

### Key points

- Successful investing is not always easy and can be stressful. Even in good times. For this reason, it's useful for investors to keep a key set of things in mind.
- The nine key things are: make the most of compound interest; don't get thrown off by the cycle; invest for the long term; diversify; turn down the noise; buy low and sell high; beware of the crowd; focus on investments offering a sustainable cash flow; and seek advice.
- These are very important in times like the present when uncertainty around inflation, interest rates, economic activity and geopolitics is high.

### Introduction

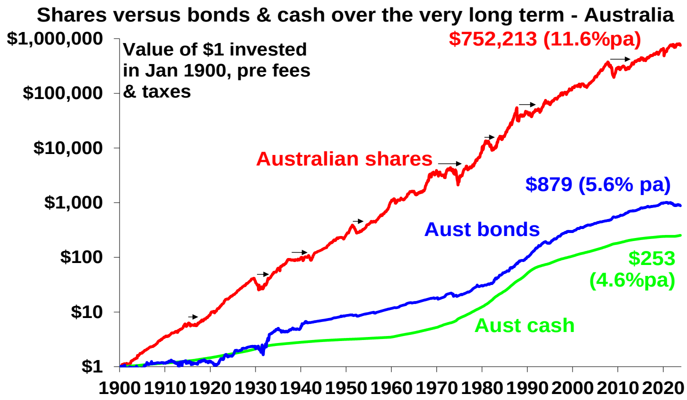
There is an ever-present worry list surrounding investment markets – usually involving some combination of concerns about economic activity, inflation, profits, interest rates, politics, natural calamities, wars, etc. It makes it hard for investors to stay focussed and avoid silly mistakes. Uncertainty is magnified by perennial predictions of a crash and then periodically by talk of the next best thing that's going to make us rich.

It would be nice if the investment world was neat and predictable, but it's well known for sucking investors in during good times and spitting them out during bad times. If anything, it's getting harder reflecting a surge in the flow of information and opinion. This has been magnified by social media where everyone is vying for attention and the best way to get this is via headlines of impending crisis. This all adds to investor uncertainty and erratic investment decisions.

With this in mind, I have written regularly about nine key things for investors to bear in mind to be successful. This note provides a reminder.

### 1. Make the most of the power of compound interest

Making the most of compound interest – which refers to the way returns compound on past returns for an investor over long periods - is the most important thing an investor needs to do if they want to build wealth. It works best for growth assets. The next chart shows the value of one dollar invested in 1900 in Australian cash, bonds and equities with interest and dividends reinvested along the way, before fees and taxes. That one dollar would be worth $253 today if it had been invested in cash. But if it had been invested in bonds it would be worth $879 and if it was allocated to shares it would be worth $752,213. Although the average return on shares (11.6% pa) is just double that on bonds (5.9% pa), the magic of compounding higher returns leads to a substantially higher balance. The same applies to other growth assets like property. So, the best way to build wealth is to take advantage of the power of compound interest and have a decent exposure to growth assets. Of course, there is no free lunch and the price for higher returns is higher volatility but the impact of compounding returns from growth assets is huge over long periods.

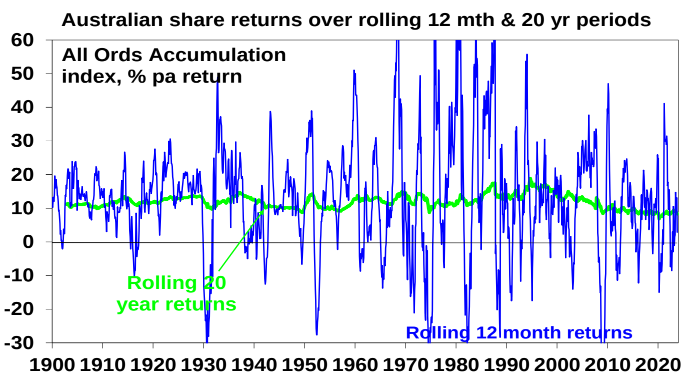



Source: ASX, Bloomberg, RBA, AMP

The volatility set off by the pandemic and now flowing from high inflation and interest rate increases does nothing to change this, any more than previous setbacks (highlighted with arrows) like WW1, the Great Depression, the 1973-74 bear market, the 1987 crash or the GFC did. The likely end of the secular decline in inflation and interest rates over the last few decades which super charged investment returns means average returns over the next decade or so will be somewhat more constrained than we have become used to. But shares offering a dividend yield of 4% (5% or more with franking credits) should still provide superior medium-term returns and hence grow wealth better than bonds where the 10-year yield is 4.50% pa. Unfortunately making the most of the magic of compounding returns can be one of the hardest things to do.

### 2. Don't get thrown off by the cycle

This is often because investment markets go through cyclical swings. All eventually set up their own reversal – eg, as falls make shares cheap and low interest rates help them rebound. But the outcome is extreme volatility in short term returns as evident in the next chart which shows the pattern of rolling 12 month ended returns in Australian shares (compared to rolling 20 year ended returns).




Source: ASX, Bloomberg, RBA, AMP

The trouble is that cycles can throw investors off a well thought out investment strategy that aims to take advantage of the power of compounding longer-term returns. But cycles also create opportunities.

Looked at in a long term context, the 20% or so plunge in share seen into October last year was just another cyclical swing, after which markets rebounded. The key is not to get thrown off when markets plunge.

## 3. Invest for the long term

Looking back, it always looks obvious as to why things happened and dips in investment markets look like great buying opportunities. But looking forward the future is shrouded in uncertainty. And no-one has a perfect crystal ball. As JK Galbraith observed "there are two kinds of forecasters: those who don't know, and those who don't know they don't know." Usually the grander the forecast the greater the need for scepticism as such calls invariably get the timing wrong or are dead wrong. If getting markets right were easy, then the prognosticators would be mega rich and would have stopped doing it. Related to this many get it wrong by letting blind faith – eg, "there is too much debt" – get in the way of good decisions. They may be right one day, but an investor can lose a lot in the interim. The problem is that it's not getting easier as the world is getting noisier. This has all been evident through the pandemic and its high inflation aftermath with all sorts of forecasts as to where markets would go, most of which provided little help in actually getting the big swings right. Given the difficulty in getting market moves right in the short-term, for most it's best to get a long-term plan that suits your level of wealth, age, tolerance of volatility, and stick to it. Focus on the green 20-year return line in the previous chart rather than short term swings.

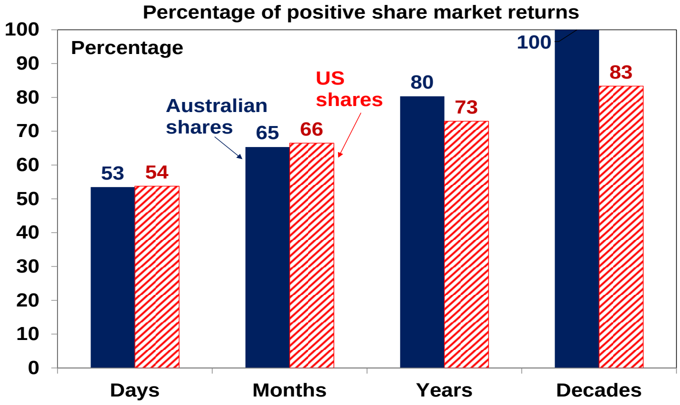
## 4. Diversify

Don't put all your eggs in one basket. Having a well-diversified portfolio will provide a much smoother ride. For example, global and Australian shares provide similar returns over the very long term but go through long periods of relative out and underperformance (eg, Australian shares outperformed in the mining boom years but global shares have outperformed since). Similarly listed assets (like shares) and unlisted assets (like property) often perform differently through the cycle. The key is to have a mix of investments.

## 5. Turn down the noise

After having worked out a strategy that's right for you, it's important to turn down the noise on the information flow and prognosticating babble and stay focussed. The trouble is that the digital world is driving an explosion in information and opinions about economies and investments. But much of this information and opinion is of poor quality. As "bad news sells" there has always been pressure to put the negative news on the front page of newspapers but there was hopefully some balance in the rest of the paper. In a digital world each story can be tracked via clicks so the pressure to run with sensationalised and often bad news headlines is magnified. This has gone into hyperdrive since the pandemic – with a massively stepped up flow of economic information. This may be of use in providing timely information on how the economy is travelling but it's also added immensely to the flow of information and often it's contradictory. The heightened uncertainty is leading to shorter investment horizons which in turn can add to the risk that you could be thrown off well thought out investment strategies. The key is to turn down the volume on all this noise. This also means keeping your investment strategy relatively simple. So don't waste too much time on individual shares or funds as it's your high-level asset allocation that will mainly drive the return and volatility you will get. Here are several tips to help turn down the noise:

- Put the worries in context – there have been plenty of worries over the last century and yet long-term investment returns have been fine.
- Recognise it's normal for markets to swing around in the short term.
- Focus on only a few reliable news services and turn off all "notifications" on your smart device.
- Don't check your investments so regularly – on a day-to-day basis it's a coin toss as to whether the share market will rise or fall but the longer you stretch it out between looking at your investments the more likely you will get positive news. See the next chart.




Source: Bloomberg, AMP

## 6. Buy low, sell high

The cheaper you buy an asset (or the higher its yield), the higher its prospective return will likely be and vice versa, all other things being equal. So as far as possible it makes sense to buy when markets are down and sell when they are up. Unfortunately, many do the opposite, ie, selling after a collapse and buying after a big rally…which just has the effect of destroying wealth even though it might feel good at the time in the midst of a panic (or euphoria). Again, turn down the noise!

## 7. Beware the crowd at extremes

It often feels safe to be in a crowd and at times the investment crowd can be right. However, at extremes the crowd is invariably wrong – whether it's at market highs like in the late 1990s tech boom or market lows like in March. The problem with crowds is that eventually everyone who wants to buy in a boom (or sell in a bust) will do so and then the only way is down (or up after crowd panics). As Warren Buffet has said the key is to "be fearful when others are greedy and greedy when others are fearful".

## 8. Focus on investments with sustainable cash flow

If it looks dodgy, hard to understand or has to be based on obscure valuation measures then it's best to stay away. Most cryptocurrency "investments" are a classic example of this. If an investment looks too good to be true it probably is. By contrast, assets that generate sustainable cash flows (profits, rents, interest) and don't rely on excessive gearing or financial engineering are more likely to deliver.

## 9. Seek advice

We are all susceptible to psychological traps like the tendency to over-react to current investment market conditions, or to pay more attention to information and opinion that confirms our own views. And the increasing complexity of investing makes it anything but easy. However a good approach is to seek advice via an investment information and/or advisory service or a coach such as a financial adviser, in much the same way you might use a specialist to look after your plumbing or medical needs. As with plumbers and doctors it pays to shop around to find a service or adviser you are comfortable with and can trust.

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