Hub Markets Update October 2014

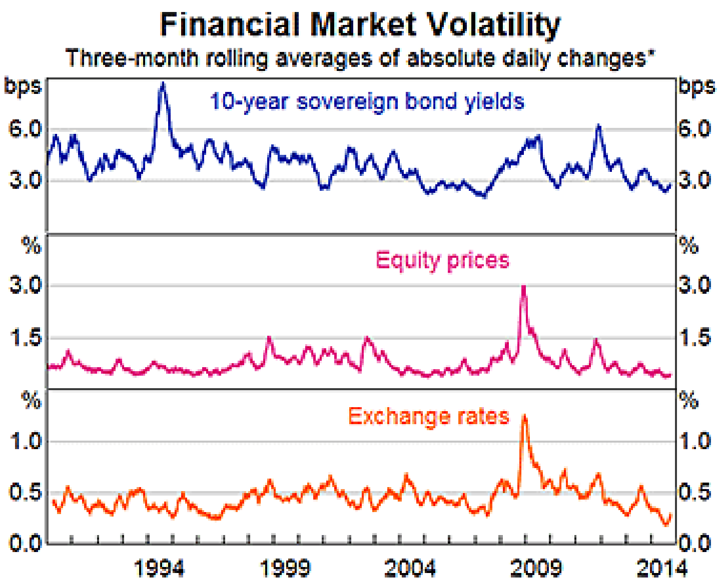
Welcome to another update from Hub Wealth Management. Here, we review recent market outcomes, with a particular focus on recent increased volatility. We look at whether this is normal, how it has impacted markets, and potential portfolio implications.

Market Volatility Has Increased in Recent Weeks

A feature of investment markets for the two years to the end of August 2014 has been the lack of volatility. This has been very unusual, as most markets have continued to rise in value.

There were a variety of reasons for this, including economic stimulus from global reserve banks, low interest rates, attractive valuations and other factors. More recently, the "search for yield" has seen investors seek higher incomes in a low interest-rate environment. This has progressively pushed the prices of income-producing assets such as shares, property, infrastructure and bonds higher. Investors have appeared to become less concerned about risk.

The graphs below give an indication of long-term volatility profiles for bonds, shares and foreign exchange markets. The clear conclusion is that volatility in each of these markets has been at historically low levels since mid-2012. At the same time, the prices of income-producing assets have risen steadily. We watch these indicators closely, as low volatility and rising prices together can suggest investors are becoming complacent.



Source: Bloomberg, RBA, Thomson Reuters

As these graphs suggest, this situation can continue for long periods of time, but not indefinitely. Therefore, the recent increase in volatility is not surprising. Investors reacted to issues including geopolitical tensions in the Middle East and Ukraine; concerns about the Chinese economy slowing; falling commodity prices; a reduction in stimulus from the US Federal Reserve, ebola, etc. Many of these issues were not new, but sentiment can be fickle.

What Has this Meant for Markets

The chart below shows outcomes for the month of September, 1 year and 3 years.

Asset Class	1 month % return	1 Year % Return	3 Years % Return
Cash	0.22	2.64	3.22
Australian bonds	-0.32	6.0	5.75
International bonds	-0.11	8.1	7.0
Aus Listed Property	-5.3	12.2	18.9
Global Listed Property	-4.9	13.9	18.3
Australian Shares	-5.4	5.9	14.8
International Shares (hedged)	-0.6	18.6	23.1
International Shares (unhedged)	4.3	20.4	22.4

What About Your Portfolio?

We do not pretend to be able to "predict" market fluctuations. However, we have incorporated a variety of strategies in portfolios deliberately to help to manage anticipated increases in volatility:

- ✓ Much **greater diversification** in shares in Australia than the market index. This has been designed to reduce reliance/risk associated with banks and resource stocks.
- ✓ **Exposure to international currency** through international assets. Typically, when there is economic concern and/or market volatility, the Australian dollar falls in value. That provides increased value for Australian investors. This happened in September (see unhedged international shares, above).
- ✓ **Maintaining portfolio discipline**, including taking profits from rising share and property investments over time. It may be boring, but it works!
- ✓ **Using flexible investments** for part of portfolios. Schroder Real Return Fund is the main example. It aims to take the least possible risk to achieve returns averaging 5% p.a. above inflation. It currently holds over 30% of the portfolio in cash and modest share exposure.
- ✓ **Use of some "alternatives".** These are strategies that do not rely on markets rising. In some cases, they can actually profit if markets fall.
- ✓ Ensuring that portfolios hold **comfortable levels of cash** and defensive holdings so that growth assets do not need to be sold at inopportune times.

Overall, we would not be surprised to see further volatility in coming months. Most importantly, we believe this is normal, and that your portfolios are well-placed to manage it.

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More Information

Please don't hesitate to contact the Hub Wealth Management team if you would like to discuss your own circumstances and portfolio with us.

Please call us on 02 9279 3400 or email us through our website at www.hubwealth.com.au

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