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Brand yourself a stayer

...you'll feel better about the share market

Australian bank shares are down. Lehman Brothers, the fourth largest US investment bank has filed for bankruptcy. Merrill Lynch has been sold to Bank of America, AIG has been rescued by the US Government... how can we say that the share market remains a wise investment?

It is because share markets do go up and down – sometimes wildly but they continue to produce great long term returns, despite this volatility. In fact the average return for the share market over the last 108 years is 12.4% per annum[1]. Whilst it would be fantastic to know exactly when the share market was about to fall and then rise – in other words be able to 'time the market', it's simply not possible. No such fortune telling device is available. The alternative which is a proven strategy, is to buy good quality companies and hold them for the long term – through good times and bad. Whilst we know from history that some companies – even great companies will fail, the overwhelming majority survive and generate good long term returns. The key to successfully investing over the long term is therefore diversification, and patience. Whilst it may seem like it's necessary to 'do something' or 'act' in response to times like this, we know that sticking to your long term investment strategy is all that's required. But what if (as some in the media suggest) things don't improve? Well things may get worse before they get better, but we do know from history that share markets will recover.

Here's why...

Every day, every hour of the day, you have good reasons to believe in the long term power of share investment. That's because shares in sound, well managed companies are not abstract pieces of paper. They represent part ownership of large companies who own valuable brands contributing to turnover and profits that ultimately support the price of their shares.

Look at the role that these brands (and others like them) play in your life. You wake up to your alarm clock (Sony - Japan), get up and make a cup of tea (Lipton – UK) and open the newspaper (Fairfax – Australia) before eating your toast and Vegemite (Kraft - USA).

You then get into your car (Toyota – Japan), grab your mobile phone (Nokia – Finland) and make a call (Telstra – Australia) to your work informing them you are running 5 minutes late. When you finally arrive at your desk, you turn on your computer (Hewlett and Packard – USA), check your email (iiNet – Australia) and work on a Word document (Microsoft – USA).

In your lunch hour you search for an outback holiday destination (Google – USA) and find a deal at your local travel agent (Flight Centre – Australia) offering airfares (Qantas – Australia) to Uluru for a great price. At lunch time, you pass by the local bank to withdraw some money (CBA – Australia) and place a small bet on your favourite horse (Tabcorp - Australia) before picking up a burger for lunch (McDonald's – USA).

You return to work after lunch, and at 5 o' clock you rush out to grab some groceries (Woolworths – Australia) and have a relaxing glass of wine at home (Fosters) while dinner is cooking. After dinner, you turn on the television (Channel 7 – Australia) to watch your favourite show whilst drinking a Coke (Coca Cola – Australia) before heading off to bed.

When you look at life this way, it is easier to understand why the Australian and international share markets keep on keeping on, even when the world economy is going badly. We consume products and services in our daily lives and indirectly support the shares and earnings of the companies that produce them. We do this even though we may have to tighten our belts and buy less when times are tough. Companies' sales and share prices are also affected by our belt tightening but we keep requiring goods and services, and companies keep on producing them.

There are strong arguments why cashing in your holding in shares or managed share funds and putting your money into a guaranteed return investment is not a good idea. Like the fact that the buying power of your capital is shrinking with inflation if it is earning a very average interest rate of around 6% on fixed deposit, compared to the share market's average growth rate of 12.8% over the past 50 years[2]. Or the fact that the share market has never before failed to bounce back to higher than its previous high and this can occur at any time without warning. Missing out on the bounce back can be very costly. For example, in the 10 years to June 2003, missing out on just the 20 best days of the Australian Share Market would have more than halved your return[3].

On the other hand, the most powerful argument of all for staying in shares and out of interest-only investments could be just opening up your grocery cupboard and looking at all the brands inside, or thinking about the companies whose products you bought and used today. These companies have not gone out of business just because their share values have dropped and, like you, they'll be around to make up for tough times when the tide turns.

[1] ASX Long-term share market returns 2008
[2] Datastream 2008
[3] Please note that historical statistics quoted report past performance, which does not guarantee future performance.
Facts and figures in this article are sourced from The Age, Colonial First State, The Australian.