

SAFEGUARD YOUR WEALTH

WITH the prospect of further sharemarket falls fuelled by the sub-prime crisis and global economic pressure, investors should be looking for protection. Economists agree that we're in for further shakiness as the US edges into recession and as the fallout from the sub-prime fiasco continues to bear down on the financial sector.

A good way to gain protection is to diversify, spreading the risk across a diverse and uncorrelated set of investment classes. By not putting all of your eggs in one basket, you can offset falls in some areas with assets that are performing strongly.

It may pay to spread your wealth into more defensive assets, which generally include cash, fixed interest and investments that follow an absolute return strategy. The downside risk with these assets is far less than that of the sharemarket, albeit often with lower returns than you'd get from strong performing stocks.

You can also look to growth assets, which do entail a higher degree of risk, but that aim to outperform inflation. Examples include infrastructure, property and private equity. Here is a break-down of how you can cut risk in your portfolio and protect your wealth from further market avalanches.

SHARES

When the sharemarket is volatile – that is, prone to sudden sharp falls – traditionally investors tend to move their money out of stocks and into safe havens such as government bonds (gilts), term deposits and fixed interest securities.

Share trading expert Michael Heffernan, a senior client advisor and strategist with Austock Securities, says that this may suit very nervous investors, but that those with a greater appetite for risk should stick with shares. "This turbulence will last for a while – it's certainly not going anywhere," he says. "So your strategy depends on your tolerance to risk. Those with a high tolerance can look

around the market and find some bargains. Banks are at their lowest price in three years with some excellent dividend returns. Some people are saying they are likely to become even cheaper."

For those that do wish to stick around and bargain stock hunt, Heffernan recommends solid, blue-chip stocks that won't be battered about as much by volatility. He adds that there are a range of strategies for concerned investors other than pulling out of the sharemarket completely: "You don't need to throw your hands up, put a fence around the sharemarket and say 'I'm not going there'," he says. "In this environment people need to keep risk low and be judicious about where they put their money. Don't put all your eggs in one basket. Always look at the alternative asset classes such as fixed interest and international shares. If you wanted to diversify there is nothing wrong with putting a certain percentage in term deposits or fixed interest or cash or shares. That is always a sensible approach."

Staunch share investors who want to snap up safer stocks should look to sectors that are relatively immune to the global financial squeeze. Any companies involved in providing essential services such as healthcare and

retail goods may also be less affected as people will still need to spend money with them, regardless of the financial environment. Finally, it makes sense to choose stocks with high dividend yields that also have low price-earnings ratios. If in doubt, speak to a broker.

SUPER

With the majority of super funds investing a large chunk of money in equities, is it time to review this strategy? Perhaps investors should be looking to move out of balanced and growth options and in to cash and capital-stable assets. According to super expert Michael Houlihan, manager of retail products and technical services at Vanguard Investments, it all depends on time horizons.

"If you're a 50-year-old setting up a self

managed super fund today, you've still got potentially 30 or 40 years before retirement, so what's happening now is probably not of much concern," he says. "If you're looking at all the corrections or bear markets over the past 50 years, they all recover in relatively short periods of time."

However, those close to drawing their pension or who already are in retirement may wish to update their strategy. One option is to look

at indexing. "Index funds protect you a bit because they are diversified across the whole range of stocks within the index," Houlihan says. "What that does is remove, to a degree, stock specific risk to a portfolio - particularly in times like this when you are seeing massive daily movements in individual stock values. With indexing, you invest in the whole index not just a part of it."

PROPERTY

With at least another two interest rate rises expected this year, and with petrol prices cutting people's discretionary spending, it is a crucial time for property investors. Those who already own property need to take various steps to ensure they can remain in the market and those who are looking to buy need to bargain hard. That's the message from property expert Margaret Lomas, who with her husband owns 35 properties and has recently authored the book '20 Must Ask Questions for Every Property Investor'. Lomas says those who already own property need to respond quickly to rate rises through increased rental income. "Firstly, make sure you are in leases with tenants that are short rather than long term," she recommends. "One of the sad facts about investing is that when interest rates go up, we as investors need to defray those additional costs."

Lomas also points out that it will take up to two years for increased rents to flow through to the landlord's pocket. "Over the past 10 to 15 years, we have had areas of low property values with increased returns. Now we're in a situation where many areas have boomed and at the same time rental returns have been slow to respond. It will take 18 months to two years for rents to catch up and cover your costs. That means in the short term property investors will have to make cuts to their personal budgets if they want to stay in the market."

Despite the dilemma of higher mortgage interest rates, investors wishing to buy should not hesitate, according to Lomas. She says we are about to see a lot of real estate bargains hitting the market in the next few months as over-enthusiastic property owners fail to



achieve their desired selling price. "During the March quarter there have been 80 per cent more properties on the market than this time last year," she says. "What that indicates is that we have people enthusiastically entering at a higher price. After a few months when their property hasn't sold, they will adjust the price downwards."

DEBT

In times of uncertainty, savvy investors can utilise their tax-effective debts to pay off their loans quicker and hedge against economic illness. AMP financial planner Phil Pilgrim, founder of Ecentral, explains that certain gearing strategies allow you to save money and make money at the same time. "People should investigate strategies that do two things at once," he says. Don't say 'I will pay off my home loan and then look to my retirement'. Instead, I think a dual strategy is imperative. You can use income generated by your investment portfolio to reduce your non-deductible home loan at a much faster pace." It's called 'debt recycling'.

So how does it work? If you have a home loan worth \$200,000 and a home worth \$400,000 you can use that equity to re-invest. You might buy another property or borrow to buy shares. Then you can go a step further and borrow \$100,000 to invest in income-producing shares. Those shares will grow over time and also pay tax-effective dividends. If you then direct those dividends directly to your home loan, you can claim a tax deduction on the \$100,000 borrowed, get a tax-effective income stream (through things like franking credits), and channel those dividends over time to your home loan. Over the first 12 months you may

have paid \$20,000 off your \$200,000 loan. What you can do is increase your loan so that your total borrowing stays exactly the same. This means your tax effectiveness goes up, your investment goes up because you are able to buy another \$20,000 worth of shares, and your dividends go up. It creates a snowball effect that accelerates your debt repayment. Over the long term you end up paying off your home loan quicker and at the end you have a fantastic investment portfolio that you've built up on the side.

ALTERNATIVE INVESTMENTS

During times of volatility, the key word is diversification. The more spread out your investments, the more protected you will be from a sharp fall in any one area. Alternative investments are becoming an increasingly popular way to do this. They are basically any asset class that has no correlation to the equity or bond markets. This can include hedge funds, private equity, venture capital, managed futures, commodities or private Real Estate Investment Trusts (REITs). Alternatives also include things like coal, forestry, art, wine, coins and agriculture. Hedge funds are one of the most popular alternative options. A hedge fund is a vehicle that invests in a whole suite of different asset classes to ensure that risk is reduced and returns are almost guaranteed. The aim of the hedge fund manager is to counteract any drop in the performance of one asset class by investing in another that is out-performing. The trick with hedge fund investing is to choose a manager with a proven track record over say three to five years. Also consider a fund of funds as this may further reduce your downside risk. [www.amp.com.au](#)