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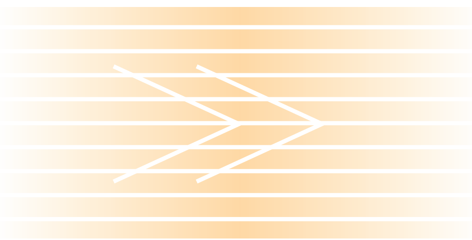


IFSA

Getting the edge with managed funds

How market volatility affects your super

With investment markets having weathered tough times over the past 24 months, super fund returns have taken a hit. It's important to understand why and see this in the context of a broader picture.

This fact sheet highlights:

- What's been happening in financial markets
- How to keep perspective in these conditions
- The ongoing advantages of superannuation.

What has been happening in financial markets?

Superannuation earnings can be positive or negative, depending on market performance.

Over the past 24 months the investment climate of markets generally, has been rocky. Several factors have had an impact including:

- problems in the US economy, resulting from the sub-prime mortgage meltdown which started in August 2007
- the subsequent limited availability of credit
- falling Australian interest rates and a stronger Aussie dollar
- economic pressures from the volatile world oil price
- siginificant slowing of global economic growth.

Falling Australian and international share markets have driven much of the decline in super returns. Since September 2008 for example, the Australian share market posted its worst quarterly performance since the 1987 crash. Australian and international share markets and the Australian listed property sector fell by double figures.

But, as explained below, large share market corrections are part of long-term investing and history shows shares perform well over the longer-term.

How to keep perspective

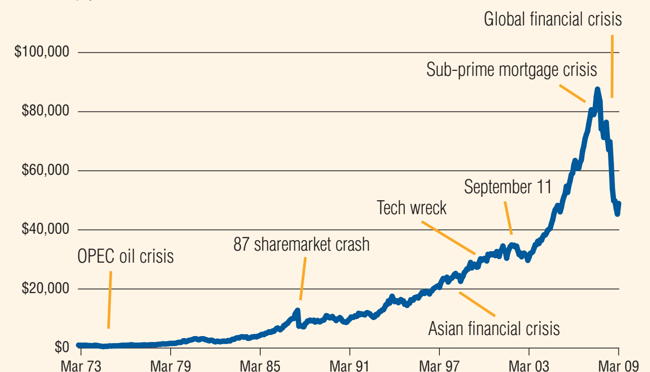
1. All investing carries some risk - markets move in cycles

Investing by nature, whether inside or outside the superannuation environment and regardless of most types of asset, carries some risk.

Investment risk or 'volatility' is the extent to which returns fluctuate from their average growth rate over time.

Downturns and recoveries

Growth of $1,000 in Australian shares since 1973[1]



- The 1974 OPEC oil crisis sparked a 50% drop in the market. Four years later, the market had recovered its value, and continued to climb higher for the next two years.
- On 20 October 1987, the Australian sharemarket - measured by the All Ordinaries index - fell 25% in one day and continued to lose ground over the next five months. It took six years for the market to regain its value, but since then, the All Ordinaries has risen more than 200%.
- In 1997, the Asian crisis resulted in a 10% slide on the market in a single month. One year later the market returned to its original value and gained an additional 10% the following year.
- The 'tech wreck' began in March 2000. The Australian market held up relatively well, but US shares plummeted. In the wake of the tech wreck, the NASDAQ index slumped 64%.
- In late 2001, the continued fallout of the tech wreck, signs of a world economic slowdown, corporate scandals and September 11 sparked a 12% slide on the All Ordinaries index over a 3-month period.
- In the wake of the sub-prime mortgage crisis in the US, the S&P/ASX 200 index of the Australian sharemarket fell by a combined total of 2.7% over June and July of 2007. However, by the end of September 2007 the sharemarket had recovered, rising by a total of 6.9% during August and September.
- In January 2008, the fall out from the sub-prime mortgage crisis resulted in an international credit crunch and a significant reduction in investor confidence.

[1] Based on the All Ordinaries Accumulation Index.

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The information contained in this brochure is general information only and does not take into account your individual objectives, financial situation or needs. You should assess whether the information is relevant to you and consider talking to a financial adviser before making an investment decision.

Generally, investments like shares and property carry greater volatility, with the potential for higher returns over the long term. Investments like bonds and cash generally produce more stable returns, yet these returns are comparatively lower over time (more than 5 years).

Despite short-term volatility, history has shown growth assets like shares and property outperform cash over the medium to long term.

Investment markets tend to move in cycles and market downturns are part of investing. Despite short-term setbacks, historically the value of the market has generally increased with time.

2. Longer-term results are holding up well

It's important to see recent superannuation returns in the context of past years' performance. Until 2007, Superannuation funds received double digit returns.

Despite most super funds delivering low single digit or negative returns for the year ended June 2008, results over a longer period remain strong - as the table below shows. Those invested in growth investment options for example have received returns averaged over the past five years of over 8% a year.

Super returns %pa to 31 March 2009

Median market performance	1 year	3 year	5 year	7 year
Growth funds (61-80% invested in assets like shares & property)	-13	4.4	8.3	6.9
Balanced growth funds (41-60% invested in assets like shares & property)	-7.5	3.9	6.9	5.8

Source: Chant West Monthly Multi-Manager Survey. Net of fees & tax

> Note: While Australian shares delivered 20%-plus* returns over the four years to June 2007, history shows the cyclical nature of markets means it is unrealistic to expect this outstanding performance to be sustained.

* As measured by the S&P/ASX 300 Accumulation Index.

3. Super is a long-term investment

Most people's superannuation will be invested over many decades. Those nearing retirement or already retired may need their super to last 20-plus years, especially given that Australians' enjoy increasing life expectancies.

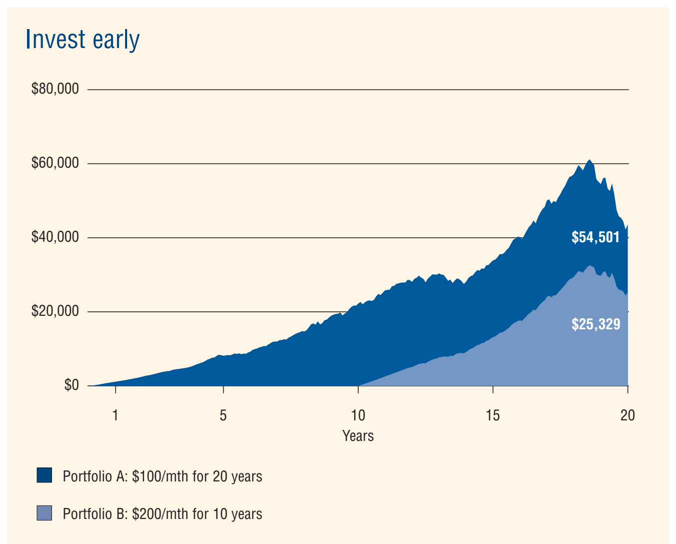
Depending on when you were born, it is possible to leave super monies accumulating, use some or all of it to start a super pension, or withdraw partial lump sums.

Because of the significant length of superannuation investments, most people have enough time to ride out fluctuations in the market and enjoy long-term market gains. So when looking at the returns you experience, don't just focus on the last year, look at the 5 year performance and consider how this smooths out the short-term fluctuations.

4. Early & regular investing pays off

The compulsory, regular nature of superannuation savings - and the fact investment earnings must be re-invested in your super account and can't be accessed until you reach a certain age, provides particular advantages:

- Because markets move up and down, by buying regularly into an investment, sometimes prices will be up and sometimes down. As a result, the average price you pay over time is smoothed. You can buy more shares or units when prices are low and fewer when prices are high.
- There is also the power of compounding where, because your returns are reinvested, you are earning money on your previous earnings. Over the years this really adds up. It is important to start investing early, to take full advantage of compound interest.



Source: Morningstar

The chart above shows two strategies which both invest a total of $24,000 as regular payments. Starting 10 years earlier helps Portfolio A accumulate a far greater amount through the benefits of compounding. Investing a regular amount each month also helps to smooth out the ups and downs of investment markets.

5. Thinking of taking action? Don't panic

Making impulsive decisions in response to short-term volatility might make you worse off in the long run. It's important to think through where and how your super is invested.

Sticking with a well-thought-out strategy usually delivers benefits in the long term. That doesn't mean taking a 'set-

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and-forget' approach to super, as your circumstances can change. But it does mean looking to the medium-to-long term and not getting spooked by short-term volatility. Your financial adviser can work with you to develop an effective strategy that is tailored to your needs.

When markets are down some individuals become nervous and consider moving their investment to cash as a safer, more sheltered option. But, studies have shown many investors move into cash at precisely at the wrong time and miss a significant part of any market upswing.

Switching investments or withdrawing your super when markets are down can mean you 'crystallise' a loss by selling at a low price, rather than waiting until markets rebound. What's right for you will depend on your personal circumstances.

If you are unsure, consider seeking advice from a financial adviser.

Investing: your choice

Most funds give members choice about what sorts of assets their super is invested in. The table below shows the differing returns over 5 years on a range of investment classes.

5 year returns on a range of investment classes

	Cash	AUS Bonds	Property Trusts	AUS Shares	Int'l Shares
31-Mar-05	5.56%	4.80%	19.76%	25.40%	9.29%
31-Mar-06	5.80%	6.74%	18.21%	30.22%	28.57%
31-Mar-07	6.19%	3.68%	28.40%	22.03%	1.94%
31-Mar-08	7.01%	4.31%	-22.81%	-7.22%	-14.15%
31-Mar-09	6.69%	12.77%	-57.64%	-29.80%	-23.97%
Annualised Total Return	**6.25%**	**6.41%**	**-9.88%**	**5.36%**	**-1.34%**

Source: Morningstar 31 March 09

Many super funds offer diversified investment options, which means they include a number or all of these asset classes.

TIP: *It is important to understand which asset classes your super is invested in.*

If you do not make a choice, your super is invested in the fund's 'default' investment option, which may not be the most suitable for you.

How your super is invested could make a significant difference to your balance over time. This is because investment options perform in different ways and even small differences in returns can add up to large differences in assets over time. A financial planner can guide you through which asset class mix you should consider, depending on your age, circumstances and years to retirement.

Here's an example to show the potential impact of investment choice.

In 1997, Jane invested $50,000 super in a 'growth' investment option and earned an average 7.2%^ per year. Ten years later she had $100,000.

Sarah invested the same amount at the same time, but chose a 'capital guaranteed' investment option. She earned an average 5.2%* a year, leaving her with $83,000 after ten years.

That's a $17,000 difference, due to choosing different investment options.

Source: Figures from www.fido.gov.au

^ the lowest average rate of 'growth' investment options and *the lowest average 'capital guaranteed' rate - over 10 years to 30 June 2007.

The advantages of super

When it comes to saving for retirement, superannuation offers several attractive advantages.

1. Significant tax benefits

> Pre-tax money contributed to super is taxed at just 15% and investment earnings at a maximum of 15%. That's significantly lower than most people's marginal tax rate.

> Once they turn 60 most people can access their super tax-free. And there can be other benefits by starting a pension from super - for example, all earnings supporting a pension are tax free. (See www.ato.gov.au)

2. Added rewards

> Many Australians can pick up a bonus from the Government of up to $1,500 a year into their super account, if they earn under a certain income level and make some after-tax contributions themselves.

3. Insurance cover

> Many super funds provide members with automatic death and disability insurance. There may be advantages over taking out insurance individually outside super - such as lower premiums, extra cover inclusions and not having to answer medical questions or undergo tests for basic cover, but payouts to a nominated beneficiary can take

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significantly longer, as the funds trustees must sign off on the payout.

4. A strong, well-regulated system

- Super funds must comply with strict laws and are regulated by Government bodies: the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).
- Licensing requirements and supervision of super funds has become even stronger over the past few years, including further risk controls.

5. Economies of scale

- Choice and market competition have driven down overall fees across the superannuation industry. Research in 2008 by Rice Warner found that super fees had been reducing as a percentage of assets since they were first assessed in 2002.
- Because people's super money is pooled together in what is known as a 'Managed investment', individuals gain access to investments that would generally only be available to large institutional investors. They may also be able to combine a wider variety of investments than they could with the same money outside super.

Getting advice

Financial advice can help individuals make decisions about their super with confidence and avoid emotional responses and hasty decisions in response to market volatility. More information about the value of advice can be found at www.goodadvice.com.au

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