SELECTING APPROPRIATE STRATEGY AMID VOLATILITY OF MARKETS SHOULD BE DECIDED FROM START

Ultimate goals key to determining level of investment risk

Barry O'Neill: safer

BY BARRY O'NEILL

The importance of having a well defined investment strategy over the past decade should be crystal clear to anyone who started without one.

Much is made of the so-called "lost decade" from the turn of the millennium, but in reality it was only "lost" if you failed to diversify your portfolio sufficiently to include assets that were not closely correlated to equities.

Investing over the past 10 years has been fraught with danger for anyone speculating that equities were the only game in town.

The FTSE All-Share index returned 53.95% from June 1, 2001, to June 1, 2011.

This was well in excess of inflation as represented by the retail prices index which grew by 34.56%, and the reward from cash of 41.75% had you been fortunate enough to achieve a return equivalent to the Bank of England base rate.

It might surprise you, however, to learn that you could have achieved a return of 64.11% from short-dated global government bonds (in sterling terms) over the same period with a much lower level of volatility than equities.

These figures are undisputable fact.

The difficulty, however, is that no one could have forecast that accurately a decade ago.

Therefore, a safer strategy would have been to invest in a diversified portfolio spread across UK and international equity markets, with the balance in less-volatile assets such as short-dated high-quality global bonds.

This would have provided a relatively smooth investment experience along the way.

Of course, knowing in advance what level of return is required to help you achieve your objectives would have been a powerful factor in determining just how much risk to take on when you started.

The fact that most people do not have this information before setting out on their investment journey always strikes me as being akin to setting off in your car without a map to guide you to your destination.

Nowadays, sophisticated cash-flow modelling tools can help to determine the level of return you need to achieve your objectives.

One of the crucial benefits of this is that you can formulate your strategy based on the most accurate figures possible, rather than simply taking on as much risk as possible to chase what could be unnecessary returns.

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