INVESTMENT

WHAT SHOULD YOU DO WHEN ASSET VALUES FALL?

Interface

Independent Financial Advisers - Financial Life Planners

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What should you do when asset values are falling?

The reality is that asset prices will go up and down over time. Indeed, we should want prices to go down – some of the time.

Falls in asset prices and values are to be expected as part of the longer-term journey.

For the purposes of this guide we will focus on and define assets as:

Investments that are purchased and held with an expectation that the asset will provide income or will later be sold at a higher price for a profit.

The investment assets/sectors we will focus on are:

Fixed Interest
Such as corporate bonds, government bonds and similar, both in the UK and overseas

Equities
Basically shares in companies in the UK and overseas, both small and large companies

Property
This includes residential and commercial property – both UK and overseas

Commodities
Oil, gold, coper etc.

Investment assets present a difficulty for many investors, because there is often a psychological factor involved which is quite distinct from most people's normal experience.

In most other areas we are delighted when prices fall. Take fuel prices at the pumps - we feel good when we see the price falling and bad when we see them rising.

In the shops we hunt for bargains and like it when we see the price of our favourite items lower than normal.

We are conditioned to enjoy lower prices. This gets challenged when we invest or hold an asset. If our asset price falls, we can easily get unnerved, worry about it and wonder where this is taking us.

This shows up most commonly with investment into shares, which tend to move up and down more rapidly than property and sharper – in both directions – then fixed interest investments.

Commodities, on the other hand, are like shares, their prices also tend to fluctuate with significance.

The gut reaction of many private investors is to sell their shares quickly in a falling market to avoid incurring further losses. However, this is often the worst thing one can do.

Here are some reasons not to sell in haste:

1. Historically, falls in share prices, even significant falls caused by stock market crashes, level out over time. For example, the FTSE All Share Index was back to the level it had reached before the crash of October 1987 within 2 years and had more than doubled its pre-crash value within 10 years.
2. Long-term strategies and investment decisions should cope with a falling market, as the likely reason for falls is a lack of confidence amongst investors not a fundamental problem with an investment or fund or company.
3. Losses change from "paper losses" to "realised losses" only when you sell your shares, if the sale occurs after a rapid fall or when prices are low history shows this is almost always the worst time to cash in. As prices tend to recover a better time to sell, at a higher price, will arrive.
4. Panic selling has a knock on and, potentially, self-perpetuating effect. If investors as a group can work through the down periods, there is less likely to be widespread carnage and prices can revert to a more reasonable level.

Although these aspects are cited as relevant to the more volatile areas, such as stock markets and shares, the principles span all asset areas.

THE GUT REACTION TO SELL SHARES QUICKLY IN A FALLING MARKET... IS OFTEN THE WORST THING ONE CAN DO

The Proven Investment Method

The proven investment method is to use an active and well-structured asset allocation approach. The approach is simple in theory and not much more complicated in practice.

The theory is based on the understanding that different asset areas perform in different ways at different times. So, when one asset area (or sector) is doing badly, another is doing well.

If you can balance between the asset areas in a way which works with your attitude to investment risk, you can smooth out the overall fluctuations to reduce your risk, which is another way of stating 'to control your losses'.

For example, a typical portfolio might look something like this:

UK Shares	20%
Overseas shares	15%
UK Fixed Interest	20%
Overseas Fixed Interest	10%
Property	15%
Commodities	10%
Cash	10%
Total	**100%**

The asset allocation approach should be active to be truly successful in the longer term. It is crucial to explain what this means – as the word 'active' can be used in other contexts as well.

Active in this context really means dynamic and must be understood as attached to the words 'asset allocation', we are therefore describing 'active asset allocation' or 'dynamic asset allocation'; this means that you follow the basic principle of an asset allocation and you rebalance regularly. Rebalancing makes the approach active.

How does rebalancing work? It is the regular adjustments you make to your portfolio to keep the mix of assets in line with your attitude to investment risk over time. It may also consider wider economic movements, but it is mostly about the portfolio shifting because of performance.

Imagine that the portfolio example above moves from its original structure shown, because of market movements in the asset prices, so that it becomes, after some time:

	Original Mix	Mix after a few years of diverging performance in the asset areas
UK Shares	20%	17%
Overseas shares	15%	13%
UK Fixed Interest	20%	24%
Overseas Fixed Interest	10%	12%
Property	15%	12%
Commodities	10%	7%
Cash	10%	15%

The asset prices and values have moved because of performance.

Rebalancing is the process of regularly moving the assets back towards their optimum position as required. In the example above, the investor would rebalance by reducing their cash and fixed interest holdings and shifting more back into shares, property and commodities.

This would be a way of disciplining the approach to selling bits from those areas that have done relatively well and topping up those areas that have done relatively poorly; which increases the prospect of buying low and selling high.

It helps to keep the risk level managed and produces, in the longer-term, an in-built discipline to the investment structure.

Therefore, investors who use this approach tend to feel more relaxed when asset areas are falling as they know that sooner or later, they will rebalance, and this could help with better longer-term returns.

FALLING ASSET PRICES IN ONE AREA CAN EVENTUALLY WORK TO YOUR ADVANTAGE

The change falling assets create in the overall portfolio split can eventually be rebalanced.

This leads to a discipline of buying when values are lower and selling when higher, at least in part. Played out over the longer term, this helps the portfolio position both in terms of risk and possibly the long-term return.

Emotional and Behavioural Considerations

This is probably a subject worthy of its own guide.

However, to summarise a little here, the science behind emotional and behavioural finance has started to reveal how important these are in the approach to money management and investing.

We all tend to react in certain ways to certain events and make decisions driven more by our emotions than we would probably realise.

Examples abound, but in terms of market falls, investors can become gloomy or panic and start to behave differently. This can include making irrational decisions to sell out (often at the worst possible point) or even more significantly, suddenly believing they can sell and then buy back at a 'better time'. On this latter point the evidence is clear and consistent – it doesn't work.

Rarely do investors relax when their portfolio value, or a part of it, is falling. Nor do they welcome this. Yet – rationally – if such an event is normal and to be expected then what difference does it make?

The biggest challenge with investing tends to be the longer-term aspect. Measurements must be made, and results judged over long periods. In the moment this can be difficult to maintain.

Even two years can seem like a long time when markets are falling. Yet, in investing terms, two years is short-term. Rational investors realise this and will simply accept the down times as normal periods, that are inevitable.

More than this they will see this as an opportunity to keep a close eye and when the time is right rebalance for their longer-term benefit.

THE BIGGEST CHALLENGE WITH INVESTING TENDS TO BE THE LONGER-TERM ASPECT... IN THE MOMENT THIS CAN BE DIFFICULT TO MAINTAIN

Conclusion

It is not easy being a rational investor!

The emotional angle covered in the previous section is a natural one, as we all want to enjoy our lives and avoid difficulties.

When investment values are falling, we can easily allow our minds to project into the future and foresee difficult or uncomfortable outcomes.

The iron discipline and unemotional characteristics of a professional investor are difficult to learn or absorb. However, there is likely to be much less stress and, in practical terms, a better outcome by adopting this approach.

Rationally it is wise to expect and then relax about asset price or market falls. If the basic investment position you have chosen is built upon strong foundations, then there is no reason to worry, panic or leap into action.

There should always be regular reviews and it may be that if a prolonged or unexpected fall occurs a review is made to explore how this affects any of the plans and – possibly – if this gives rise to any fresh opportunities?

The history of asset markets and price movements in those markets show that they fluctuate and there have always been periods when prices have fallen, these are part of the normal cycles and should pose no threat to any investor.

Provided the investor has a well-structured risk position and their investment portfolio is part of a robust financial plan.

History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.

ALAN MORAN
Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

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