

We all want to back a winner with our investments. But chasing last year's performance can get you into strife. Last year's investment performance is not a good indicator of next year's returns.

While you might be able to pick the future performance of a sports team based on last year's performance, this is often because you know the team, you know the competition and the environment doesn't change.

However, with investment markets, it's more difficult. Factors such as interest rates, exchange rates, commodity prices and environmental issues all come into play at a global and local level to influence performance. As a result, last year's winner can easily become 'yesterday's hero' (Figure 1).

### Living with volatility in investment markets

Investment markets can be volatile, with strong returns in some years and significant declines in others. For Australian investors, Australian and international shares have been the most volatile asset classes, experiencing best performance and worst performance more often than property, cash or bonds.



**Figure 1 — Annual performance of asset classes**

Last year's best performing asset class can easily become next year's worst

Year to 31 December	Australian shares (a)	Property (b)	International shares (c)	Australian bonds (d)	Cash (e)	Year to 31 December	Australian shares (a)	Property (b)	International shares (c)	Australian bonds (d)	Cash (e)
Dec-89	17%	2%	<b>27%</b>	15%	18%	Dec-99	16%	-5%	<b>18%</b>	-1%	5%
Dec-90	-18%	9%	-15%	<b>19%</b>	16%	Dec-00	4%	<b>18%</b>	<b>2%</b>	12%	6%
Dec-91	<b>34%</b>	20%	21%	25%	11%	Dec-01	10%	<b>15%</b>	-10%	5%	5%
Dec-92	-2%	7%	6%	<b>10%</b>	7%	Dec-02	-8%	<b>12%</b>	-27%	9%	5%
Dec-93	<b>45%</b>	30%	24%	16%	5%	Dec-03	<b>16%</b>	9%	-0%	3%	5%
Dec-94	-9%	-6%	-8%	-5%	<b>5%</b>	Dec-04	<b>28%</b>	32%	10%	7%	6%
Dec-95	20%	13%	<b>27%</b>	19%	8%	Dec-05	<b>21%</b>	13%	17%	6%	6%
Dec-96	<b>15%</b>	14%	7%	12%	8%	Dec-06	25%	<b>34%</b>	12%	3%	6%
Dec-97	12%	20%	<b>42%</b>	12%	6%	Dec-07	<b>18%</b>	-8%	-2%	3%	7%
Dec-98	12%	18%	<b>33%</b>	10%	5%	Dec-08	-40%	-55%	-24%	<b>15%</b>	8%
<b>Average annual 20 year return</b>							<b>9%</b>	<b>7%</b>	<b>6%</b>	<b>10%</b>	<b>7%</b>

Source: Datastream. (a) As measured by the Blended All Ordinaries Index. Post 31/3/2000 S&P/ASX All Ordinaries Accumulation Index. Prior to 31/3/2000 ASX All Ordinaries Accumulation Index. (b) As measured by the Blended Property Trusts Accumulation Index. Post 30/6/2002 S&P/ASX 300 Property Trusts Accumulation Index. Between 1/4/2000 and 30/6/2002 it was the S&P/ASX 200 Property Accumulation Index. Prior to 1/4/2000 the benchmark was the ASX Property Trusts Accumulation Index; (c) MSCI World ex Australia Accumulation Index \$A; (d) UBSA Composite Bond Index; (e) UBSA Bank Bill Index. Past performance is not indicative of future performance.

## Figure 2 – Markets have always recovered

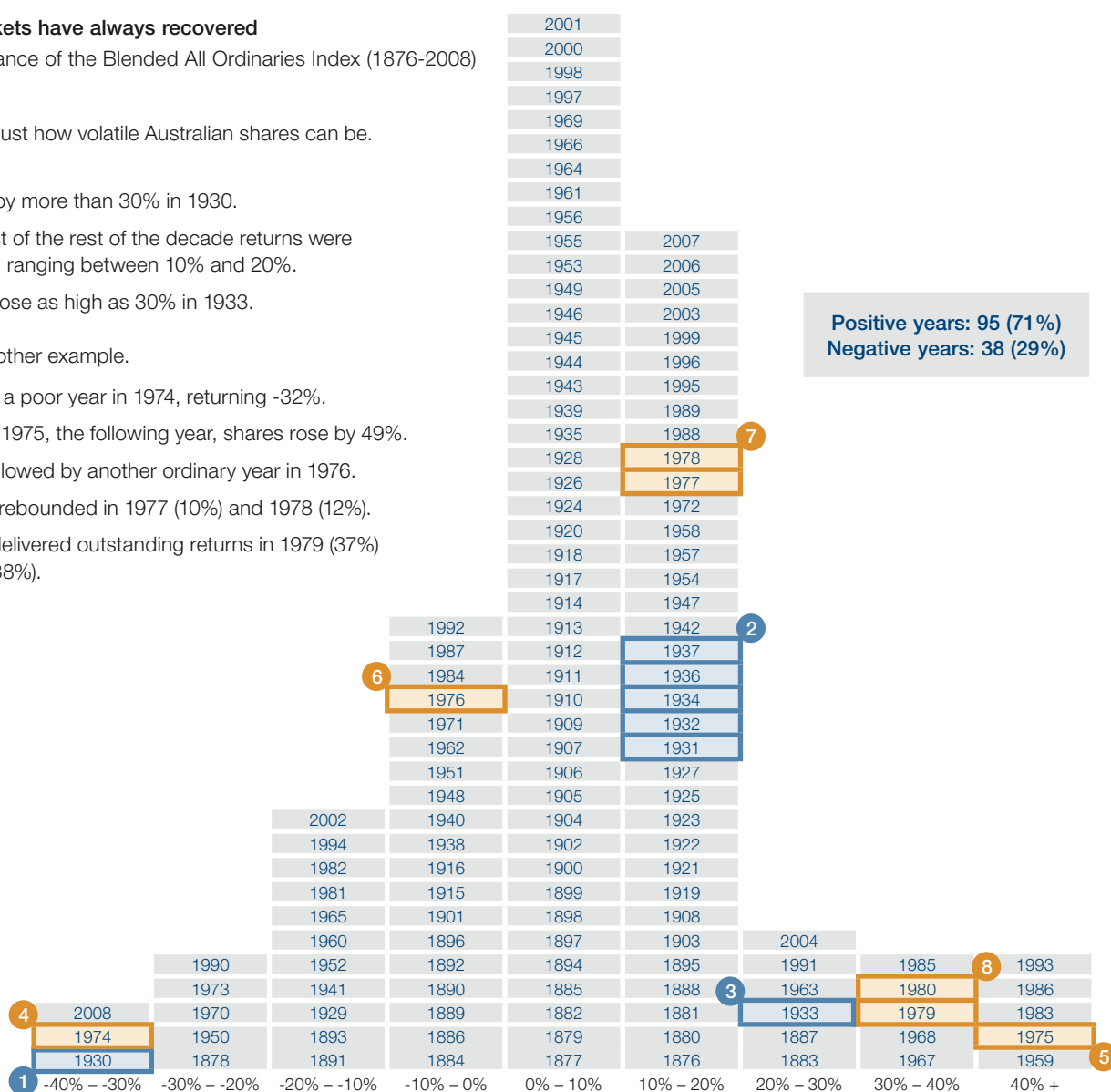
Annual performance of the Blended All Ordinaries Index (1876-2008)

Figure 2 shows just how volatile Australian shares can be. For instance:

- 1 Shares fell by more than 30% in 1930.
- 2 But for most of the rest of the decade returns were very strong, ranging between 10% and 20%.
- 3 They even rose as high as 30% in 1933.

The 1970s is another example.

- 4 Shares had a poor year in 1974, returning -32%.
- 5 However in 1975, the following year, shares rose by 49%.
- 6 This was followed by another ordinary year in 1976.
- 7 But shares rebounded in 1977 (10%) and 1978 (12%).
- 8 They then delivered outstanding returns in 1979 (37%) and 1980 (38%).



Source: Goldman Sachs JB Were. As at 31 December 2008.

### The lesson from history is that time heals

While the swings in the markets might look extreme over one year, they are less pronounced over the long term since, traditionally, sharemarkets have recovered from short-term setbacks with significantly higher gains.

It's also important to remember that while volatility may be unpleasant, it can provide opportunities.

### Diversification can smooth the ride

Diversifying your money across a range of asset classes can help you ride out the performance troughs in the market and the good returns in some investments can help offset the poor returns in others. Having a diversified portfolio can mean the best performing asset class offsets the worst performing asset class.

You can read more about diversification in our guide to investing 'Why diversification is important'.

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