Insight

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From the Investment Team
Fiducian Investment Management Services

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Your Fiducian Financial Planner

To counter market uncertainties, investors should hold properly diversified portfolios with the help of a financial planner

Diversification an advantage to weathering current volatility

Further to our report on China, *Global storm before the calm*, and given recent market volatility, our clients may want to know what Fiducian's investment strategy is currently and what action, if any, has been taken by the Investment Team.

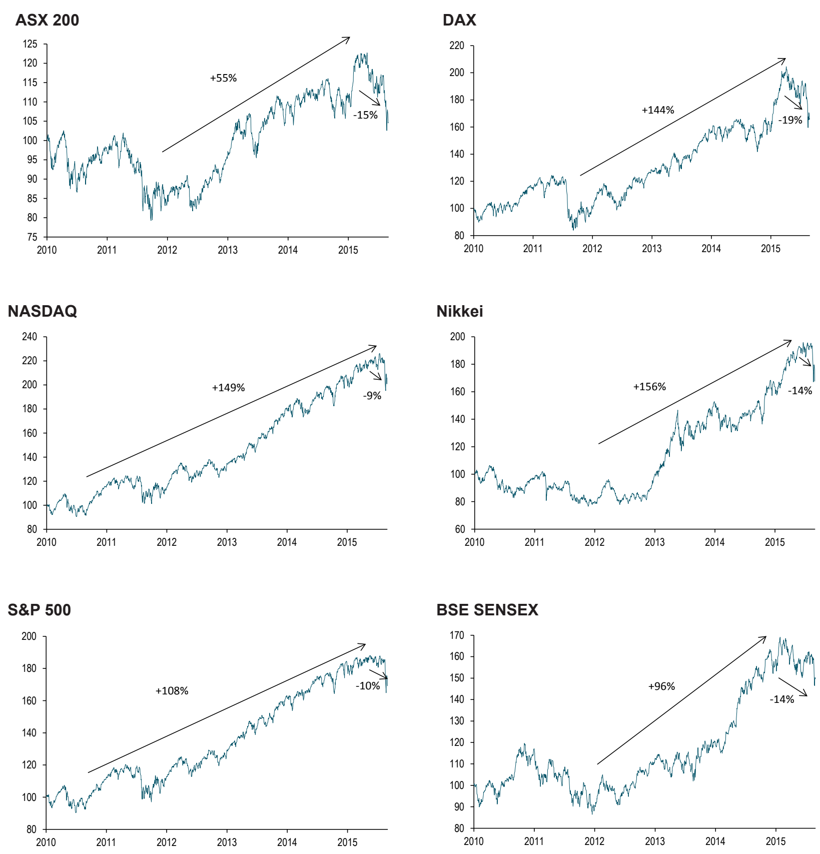
The resolution of the Greek debacle and gyrations of the Chinese stock market highlight how important it is for the Investment Team to remain attuned to global, as well as domestic events and to address these events within the ambit of our Manage the Manager System (MTM), which by its inherent nature reduces the risk of reliance on any single fund manager's investment strategy by diversifying security selection risk, key-man risk and the risk of unexpected individual investment decisions that may have gone awry, across a range of competing fund manager strategies specially chosen to manage our clients' monies.

In addition, the Investment Team continues to assess key technical factors to make gradual shifts in asset allocation which are reported within the Monthly and Quarterly investment strategy reports.

The big picture for major share markets

Over the last four years the US stock market has risen significantly and so have the markets of the rest of the world. When the stock market of the world's largest economy rises, it is positive for the rest of the world. Recent share market declines, while sharp and swift (and including some recoveries), have not eroded the bulk of the gains made over the past few years, but some investors remain jittery due to their experience of the Global Financial Crisis that erupted in 2008 and their understanding of the damage that can be done to their investments under certain circumstances. Relevant share market statistics are illustrated below.

Global Market Indices Charts



The US economy too has strengthened to a degree over the last few years. Unemployment has fallen significantly and the US central bank (the 'Fed') could soon begin to lift official (short-term) interest rates from near-zero per cent even though inflation remains dormant. By itself this could seem to be an appropriate response to a strengthening economy and particularly a strengthening employment market.

On the other hand though, a US rate rise could bring other factors into play, which could have global ramifications. In particular, this could push the US dollar even higher than it is already and affect both US exports and those in other parts of the world holding large quantities of US$-denominated debt.

As a further consequence, capital could flow out of some emerging market economies (particularly those relying on commodity exports), their currencies could weaken further and their debt-servicing burdens could be exacerbated. Given that developing economies in total account for around 40% of world output, such an eventuality could prove damaging for the developed world too.

It could be this uncertainty that has somewhat unsettled investors.

No looming signals of a major market setback

We have the following views which argue against being bearish about the current outlook for key global share markets, although market volatility could be heightened over coming months:

1. While there has not been a general market correction of more than 10% over the last three years, recent poor data out of China gave investors a chance to 'take stock' and most global markets corrected somewhat during August. However, the accommodative monetary stance of central banks in the developed world has underpinned market performance and continues to do so, due to near-zero per cent interest rates in most jurisdictions and ongoing 'quantitative easing' in Europe and in Japan in particular, as well as monetary easing in China.
2. While there is the potential for an imminent increase in interest rates in the US to cause the US share market to wobble (and this could occur as soon as the Fed's next meeting on Thursday 17 September), in our view any market decline could be short-lived and it could take a long time before interest rate 'normalisation' could become genuinely restrictive.
3. Furthermore, there are no compelling indications of major developed economies facing a recession over the coming year. Policy generally remains supportive of at least moderate growth and, in consequence, a severe market downturn due to recession currently appears unlikely.
4. From a contrary perspective, there is no euphoria or "irrational exuberance" that could also signal the onset of a general market downturn (such as recently occurred in China's Shanghai 'A' share market).
5. Valuations of share markets no longer point to them being as cheap as they were. However, the economic environment has changed and historically low interest rates have affected the relative calculations. Furthermore, in competition with most bond markets, most share markets appear to represent better value.

The investment team addressed this need for caution with our diversified funds, by paring back domestic equities to around benchmark weightings and allowing cash holdings to build slowly including by investing new fund inflows into cash

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Action taken by the Fiducian Investment Team

So while there have been no obvious danger signals pointing to a large share market correction, there have been reasons for near-term caution. The Investment Team decided to address this need for caution and so from early June onwards:

- pared back domestic listed securities (Australian shares and listed property securities) from an overweight position to around benchmark weightings for our diversified funds
- allowed cash holdings to build by investing new fund inflows into cash, and
- marginally reduced international share exposure, but held it above benchmark in anticipation of likely weakness in the A$.

These moves have provided support to our diversified funds in particular, given volatility experienced in mid- to late-August and helped preserve some of the value we had created previously.

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Fiducian MTM Advantage – Attractive returns for our investors

The flagship Fiducian funds are our diversified funds and these invest in our Fiducian asset-sector funds. Through a combination of asset-sector performance and asset allocation at the diversified fund level, these have delivered attractive returns for our clients in comparison with their Australian and international peers. Our results to June 2015 which give an idea of short- and long-term consistency are shown below:

	1 year		5 year	
	Rank	Returns	Rank	Returns
Capital Stable Fund	5/117	8.8%	26/100	7.4% pa
Balanced Fund	8/188	14.7%	43/153	10.3% pa
Growth Fund	3/188	16.6%	10/153	11.2% pa
Ultra Growth	2/113	18.8%	8/93	13.1% pa

To reduce risk for an expected return, in each Fiducian asset sector fund, we use multiple specialist investment teams with competing investment strategies rather than rely on a single-star fund manager who may not be able to continue to outperform for various reasons.

The Investment Team manage and rebalance exposure to these strategies so that clients do not have to worry about making haphazard or repeated changes with unintended tax or performance consequences to what should be long-term portfolios established to deliver the financial outcomes that our clients are looking for over time.

As always, Fiducian's Investment Manager Conrad Burge says that to counter market uncertainties, investors should hold properly diversified portfolios for capital growth, income and risk minimisation constructed with the help of a financial planner.