the Investors' Voice

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Keeping inflated promises

By Doug Turek

Although it's more than 30 years, or a generation, since inflation ran amok with individuals' finances, it may pay to be aware which investments work and which don't if inflation returns. History is replete with examples of governments that, faced with having to cut spending or raise taxes to deal with overspending, chose instead to put less precious metal into coins, print more money or add more zeros to their bank account. Conspiracy theorists may note that the last time the US government had as much debt as it does now was in the 1970s when perhaps conveniently inflation broke out, helping to cut in half its debt as a proportion of GDP.

Most retirement portfolios can survive a prolonged period of poor share market performance; but inflationary periods are very harmful, because of the dual effect of rising living costs and poor across-asset-class returns. Figure 1 below shows the balance of an initial $1m retirement savings portfolio by year of retirement funding, for different retirement starts since 1870. It shows that the worst time to have retired was at the start of the 1970s inflationary era when your money would have lasted only a short 13 years. This compares to 37 years if you retired at the start of the Great Depression or 30 years if you modelled your retirement using average, not actual, returns and inflation.

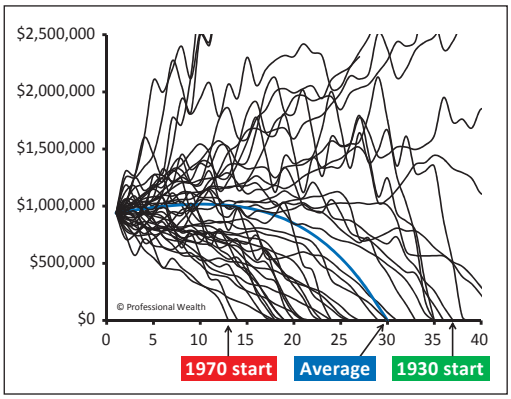


Figure 1: Retirement portfolio balance by year of retirement after drawing out an initial 6% actual-inflation adjusting income, invested in a 60/40 Australian shares/bond portfolio earning actual historic returns, for differing start years of retirement beginning in 1870 and every 3rd and 5th year thereafter until last retiring in 1980. Source: Professional Wealth

So what works and what doesn't if inflation returns?

Shares

Shares can be a good inflation hedge, but only over the longer term. A diversified share portfolio makes enough money in non-inflationary times to more than compensate for poor performance during inflationary periods. However, in the short term, companies can struggle to raise prices quickly enough (or shrink package size) to keep up with rising wages and factory supplies. Rising interest rates increase company costs and cut consumer budgets, resulting in lower sales volumes.

Further, the prices investors are willing to pay for shares fall with overall pessimism and as cash and new bond yields become more attractive. In the 1970s the poor real performance of shares was driven more by falling P/E ratios than by struggling corporate earnings.

That said, not all companies perform similarly.

Better performers include resource and energy companies that benefit from commodity prices rises. BHP, Rio, Newcrest and Woodside are some of the companies that should benefit, or arguably have benefited, from inflation concerns. Soft commodities like agriculture and timber should also perform, but unfortunately not if you accessed them via failed MIS investments.

Utilities and other infrastructure assets are sought out for inflation protection because they enjoy CPI-linked revenue streams. But they must be selected carefully — a developed toll road or water utility can be expected to perform better than a utility forced to buy higher-priced coal or gas to fuel its generators. The past offer for Transurban by an overseas pension fund was a sign that some are taking the threat of inflation seriously. Unfortunately Telstra can probably no longer be considered a utility-like inflation hedge.

Continued on page 4

Wealth Creation Opportunities: 1–3 September 2011

Only one month to go before the AIA's National Investors Conference is held at the Sofitel Sydney Wentworth Hotel. Spaces are still available. **Call 1300 555 061 to register.**

The conference all investors should attend.

AUSTRALIAN INVESTORS ASSOCIATION

President's message

By Alison Harrington

It is very exciting that the registrations for our Annual Conference in September have been so good that we will probably have to close off our books. I hope this is because investors are getting the message that education is more the key in downturns than in upturns.

Talking to members, I find many have learnt a lesson from the GFC. Before 2007 you could do a good fundamental stock selection and in many cases hold and prosper. Now members are finding they need to develop good technical skills as even stocks with good fundamentals go on a rollercoaster ride of price variation. To add to the confusion there is an increasing number of service providers giving technical and fundamental advice for a fee. Many of these are excellent and are well known to AIA members. The problem is choosing which one suits you and how much you should pay over a year for professional advice. When you pay fees for managed funds you don't actually see how much it is costing you, so it is not common to put in as much research into the value you are getting for your money as when you actually 'write the cheque' yourself.

The AIA is increasingly appreciating the value it can offer to members by giving them the basic knowledge to make informed choices as to their personal investment needs and where and how they access professional advice. To date this has been a service provided by the many experienced investors within our membership. To make it even more effective we have now employed Joanne Stuhmcke, who has an excellent investing and work history, to coordinate our web-based education knowledge. Joanne's initial role will be to get the education portion of the website working. In the future we expect the role to include better coordination of seminars, development of more online and face-to-face courses, and many other initiatives. As we are 'investors helping investors' the underlying guiding principle of the role will be to assess the needs of our members and the skills we have within our membership, and to use that skill base more effectively. So, as members, you will be hearing a lot more from Joanne. Her first request has been to ask for assistance in content development. Please don't be shy — put your hand up!

The Board are very excited that we are in such a strong financial position to be able to afford this new role. Our thanks particularly go to Silvana Eccles and to Chris Kesting, of our Secretariat, for managing our organisation and our conference so well. Above all we thank you, our members, for your continuing support and enthusiasm for what the AIA can do for independent investors.

The AIA China Study Tour

By Graham Rich

In just 30 years, China has transformed itself from a centrally planned, closed economy into a market-oriented one. This restructuring has contributed to a more than tenfold increase in GDP since 1978. Last decade, we saw the 'arrival' of China. In 2010, it was the world's largest exporter and outperformed all other major economies with GDP growth around 10%, cementing its position as the world's second-largest economy after the US.

This decade, the more striking story will be the rise of China's new middle class. As the incomes of its 1.3 billion people rise, the demand for value-added goods (cars, office equipment, technology, etc.) will provide significant opportunities for global companies — and for those building portfolios.

Investors cannot ignore China (whether invested there or not). It will have an enormous impact on Australia's economy and global investment markets. We all need to understand its influence on portfolios, and the most effective and rewarding way to learn about and understand any investment market is to experience it yourself.

About the tailored AIA China Study Tour

Since 2006 we've led more than 80 investors on China Study Tours, and now we're offering a tailored Study Tour for AIA members. This is a week-long, in-country immersion program featuring a unique faculty of investment and business experts from within China, including our local 'elder statesman'. It will materially increase your understanding of the market, the economy, the business environment and the society, as well as its influence on your investment portfolio. Plus you'll get to experience two amazing cities and one of the great architectural wonders of the world!

- Our Study Tour begins on a Sunday in Shanghai, China's dynamic commercial capital. After an orientation briefing, we take a guided walking tour of the city.
- On Monday we have a series of briefings on China's economy and business environment, as well as backgrounders on its equity and debt markets.
- On Tuesday we're out and about in Shanghai for two investment case studies.
- On Wednesday morning we fly to Beijing, China's political capital, and travel by bus to a purpose-built, traditional Chinese training facility at the foot of the Great Wall for an in-depth briefing with our Chinese elder statesman discussing China's complex society. Later that afternoon we walk along the Great Wall and watch the sun go down before returning to the training facility for the evening.
- On Thursday morning we take a short walk back to the Great Wall to watch the sun rise (optional), and enjoy another session with our Chinese elder statesman before returning by bus to Beijing.
- On Friday morning we make our way to our final investment case study. Over lunch, we debate the group's key takeouts from the Study Tour before taking a bicycle tour (optional) of some of the sites of Beijing.

The proposed dates are Sunday 25 March to Saturday 31 March 2012 inclusive. The approximate cost per person will be $9000 to $9500 (excluding flights and visas, and depending on numbers). Please send expressions of interest or queries direct to Deirdre Keown, telephone 02 9247 0497 or email mail@bricplus.net.au by 1 October 2011.

We look forward to having you join us!

Graham Rich will be the Study Tour leader and is the publisher of PortfolioConstruction Forum.

Australian share market and economic cycles

By Robert Vagg

In the May 2011 issue of *Investors' Voice* I described a recurring cyclical pattern in the earnings of Australian listed companies that has been evident since 1974. I noted that those earnings' cyclical lows demonstrate a history of occurring early in each decade, with above-average profit growth often then ensuing for some years before a high is reached later in the decade. Since company earnings are dependent on the economic environment, and share market prices are determined in turn by those earnings, it might be expected that the existence of any regular cycle in the domestic economy should be mirrored by a regular cycle in share market prices. This article describes a correlation between Australia's economic cycle and its share prices.

Volatility in the Australian share market has been shown to display a regular decadal cycle. As a component of a long-term model of the market, this cyclical pattern of volatility has been denoted as the market's Secondary Trend*. That pattern is reproduced in Figure 1 below.

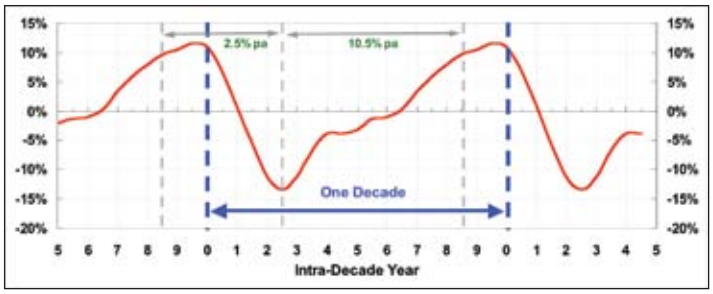


Figure 1: The All Ordinaries average volatility cycle 1875–2005

Based on the first thirteen decades of the market index's history, the average profile represented in Figure 1 shows that a peak in share prices generally occurs in the last few years of a decade (at 11–12% above trend on average). This typically has been followed by price weakness until a bottom is reached around the middle of the next decade's third year (at around 14% below trend). Subsequent strong price growth then follows until a peak is reached again late in the decade, allowing the cycle to repeat.

This pattern may be evaluated by comparing the average price growth that has occurred historically in the All Ordinaries Price Index over these two intra-decade periods. Overall, the index has averaged 5.8% annual growth since 1900. Looking only at the 6-year periods from the middle of the third year of each decade to the middle of the ninth, annualised growth has averaged 10.5% for each component year. By comparison, during the corresponding 4-year periods from the middle of each ninth year to that of the third year of the following decade, annualised price growth averages only 2.5%. This indicates that the poor growth performance displayed by our market over the last few years is not atypical. Perhaps of more value, it shows also that we are currently approaching the phase of the decade that typically acts as the market's main period of growth.

Turning to the economic cycle, the pattern of economic recessions affords a convenient way to display periods of slow GDP growth. Technical recessions that have arisen since the beginning of the last century are represented in Figure 2 in blue shading. Also shown is the path of the All Ordinaries Price Index during that time. The long-term Primary Trend* in that index is displayed as a smooth green line. When the market's decadal volatility cycle, as described in Figure 1, is superimposed on that trendline the market's Secondary Trend results, as shown in red. The market's normal volatility limits (90% confidence limits) form a channel flanking the central Secondary Trendline.

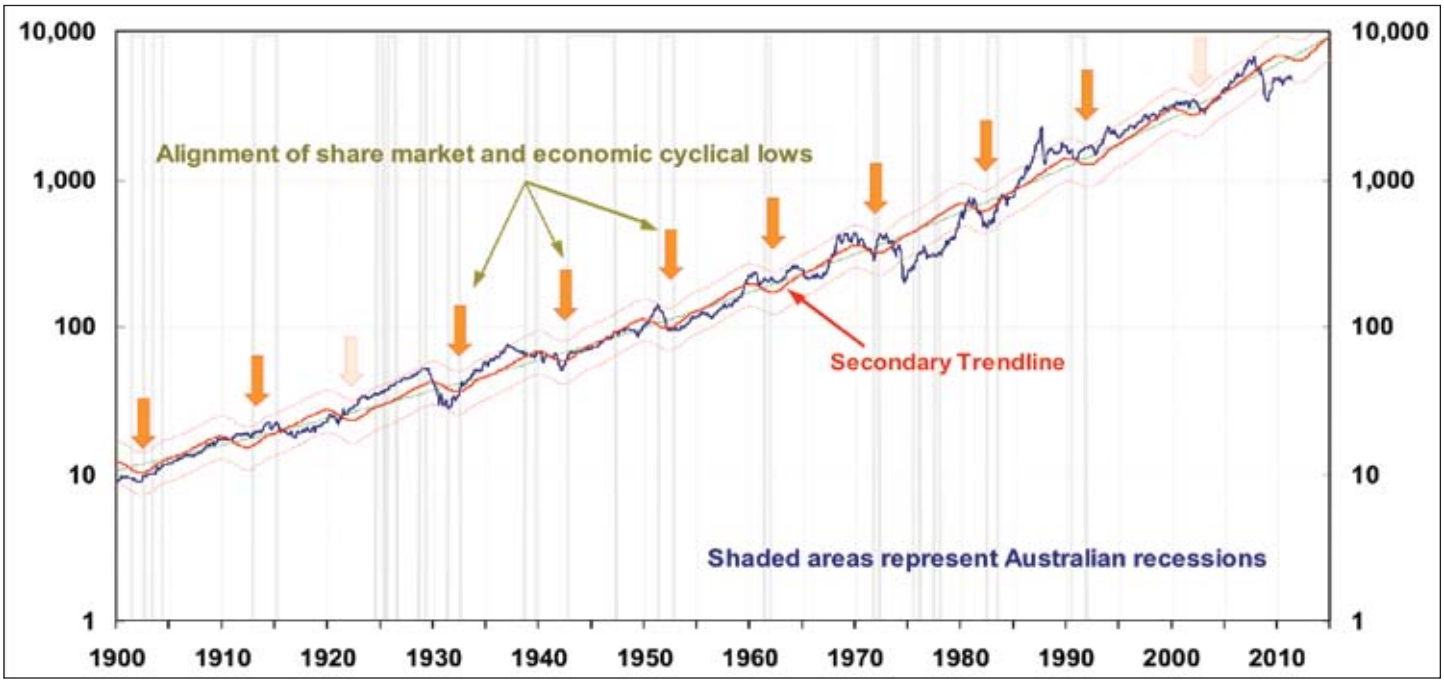
This chart allows a number of points to be made. Not surprising, there is an obvious correlation throughout between slowing GDP growth and stock market weakness. In nine of the eleven decades shown in Figure 2, there is a clear alignment of the early-decadal lows of the Secondary Trendline with the pattern of recessional lows. This correlation extends to the cyclical movements in company earnings referred to earlier.

There is current media speculation that the non–resource-related section of the Australian economy is in recession. If so, this would be consistent with the historical pattern of recessions shown. Share market lows that have functioned as accumulation phases preceding periods of above-average price growth normally have accompanied that pattern. Our share market is seen to be now tracking along its lower volatility channel limit, a level defined by its history of major lows, thereby indicating a significant degree of current undervaluation.

** For details see Robert Vagg, 'A long-term model of the Australian stock market,' supplement to Investors' Voice, May 2009 (available on the AIA website).*

Robert Vagg is a member of the AIA (email: rsvagg@gmail.com).

Figure 2: Comparison of Australian economic cycles with All Ordinaries Price Index volatility



Keeping inflated promises... from page 1

Retailers with pricing power, selling things we need to buy (consumer staple suppliers like Woolworths) should perform better than companies trying to tempt us to buy things we might be able to postpone when personal budgets tighten (consumer discretionary retailers like Myer). Similarly, manufacturers don't perform because their input costs often rise more rapidly than their prices, and sales can fall.

Unfortunately banks are expected to be losers in an inflationary environment as their loans are repaid with money worth less and less each year; also fewer customers turn up to borrow at high interest rates. The collapse of the US savings and loan institutions in the late 1980s can be traced to American borrowers having locked in low interest rates before inflation broke out.

Property

The rent that commercial property tenants pay is often linked to CPI, so commercial property trusts should enjoy inflation adjusting revenue. Indeed a bout of inflation may help distressed investors in frozen property trusts by shoring up falling commercial property prices and eroding high levels of indebtedness. After a difficult period, farmers might be pleased to find higher prices for both their land and their production.

Residential property prices generally keep up with inflation. However, after decades of increases well in excess of the 130-year Australian annual price rise of inflation plus one per cent, further price growth and rental income may be constrained by stretched affordability.

Cash and bonds

Traditional fixed interest rate bonds decline in price in the event of surprise interest rate rises. Of course if interest rates are expected to rise this is built into the price as a higher yield. During the surprise run-up in inflation to the peak rate in 1975, traditional medium-duration and long-term bonds underperformed; but once the inflation cycle peaked and interest rates came down, these locked-in investments outperformed.

Floating rate investments including cash and floating rate bonds offer better protection against inflation, provided central banks raise interest rates faster than CPI. This wasn't the case in the 1970s, nor in the 1940s and early 1950s. Today investors in the US and UK earn less on fixed and floating interest rate cash and bonds than the rate of inflation. It is ironic that many who retreat to the so-called security of cash simply exchange 'equity risk' for 'interest rate setting risk'. As was the case during the initial wave of the GFC, hybrid securities, especially those issued by banks, shouldn't be considered an alternative defensive investment.

Inflation-linked bonds are a nice complement to interest rate linked bonds and deposits. They are generally structured so that your capital appreciates with CPI and your ongoing interest is paid as a fixed percentage of that adjusting amount. Aside from short-term repricing by bond traders, your investments aren't technically linked to interest rates, removing this risk. Inflation-linked bonds can be bought through a handful of specialty inflation-linked bond funds (e.g. Aberdeen's), directly in $500,000 lumps from various issuers or in small lots issued by the Commonwealth via the Reserve Bank's Small Investor Bond Facility. Combined capital growth and income return range from about CPI plus 2–4%. In recent times prices have rallied in response to share market concerns.

Currency and international investment

Inflation and currency crises go hand in hand. This suggests the need to a have a firm view whether the Australian dollar will strengthen further or weaken relative to other currencies. On balance one might expect the Australian dollar to stay strong or strengthen further in a high inflationary environment owing to demand for Australian commodities and higher interest rates. If so, your investments offshore should be currency hedged and maybe you should buy more of them while the dollar is strong.

Gold and other collectables

Gold and other precious metals are held out as a reliable inflation hedge. This is very true during times of financial stress and provided you bought before the price boomed and sell before it busts. Due to a lack of income though, long-term returns aren't spectacular. Author and Wharton University Professor Jeremy Siegel showed that US$1 invested in gold in 1800 was worth US$1.95 two hundred years later in 2000 after adjusting for inflation. Of course that's a better result than an uninvested dollar bill, which became worth only 6 cents (a lot less than the $300 the dollar would have made if invested in bank bills). It is also true that the UK pound is no longer worth a pound of sterling silver as it was originally; otherwise it would be worth about A$500 today.

Studies of Australian blue chip art suggest prices keep up with share prices, but not the total returns including franked dividends. Unfortunately prices correlate with the performance of the stock market, suggesting that most art is bought by share investors and brokers!

* * * * *

There is evidence inflation is indeed a worry among professional investors. A hypothetical INFLATION ETF ™ I described in March 2010 is up 15% for the year to 31 May 2011 versus 9% for a growth fund benchmark.

In this current environment, fear of inflation switches back and forth with fear of deflation. It is also possible to have cost inflation coupled with asset deflation, which is a bit like life in the 1970s. Like fashion and hairstyles from that era, it's a scenario I think we'd all prefer not to see return.

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What's in store for property?

By Michael Yardney

We live in interesting times, don't we? The media is once again obsessed with fear and gloom. Just open any paper or turn on the news and you'll see the worry list for investors has blown out again to include the global economy, European debt problems, US housing, Japan and, closer to home, our property markets.

Depending on where you live, property values in your state will have grown a few per cent or dropped a few per cent over the last year. And of course the value of certain properties has fallen much more than that. Some segments of the market, in particular holiday properties, mining towns and some rural properties dropped markedly in value.

Bad news is abundant. So what's in store for our property markets for the rest of the year, and does the fear that's overhanging investment markets mean crisis or opportunity?

At other times our flat property markets would have been a terrible result, but against the backdrop of what's happened to property markets around the world and to other investment alternatives, the way our property markets performed over the last year was actually not so bad.

Sure things are tough in some regions, and I'm not pretending that the year ahead will be easy. It won't be. But it will definitely be a year of opportunity. It's another year when the gap between the rich and the ordinary Australian will widen.

Before you say, 'Oh Michael, you're not going to recommend buying property again,' let me remind you — and I'm sure you've witnessed this phenomenon — some investors seem to do well in good times and do even better in tough times, while others do poorly in good times and even worse in tough times.

Why is that so?

Quite obviously if some investors consistently do well overall, even in those markets where others fail dismally, it must be something internal, something within them that makes the difference. If you've been to any of my seminars you'll know that I believe it's an individual's mindset, more than any other external market force, which determines success.

Some investors will do very well in property over the next few years because they have the ability to sift through the clutter of mixed messages. While many people will be sitting on the sidelines waiting for things to get better, a small group of savvy investors are out there already taking advantage of the opportunities the markets present.

I recently reviewed the house price statistics for the last 12 months for Brisbane — a market that many would say has been going backwards. Interestingly, in a year when the overall growth in median prices was negative, there were quite a few suburbs that experienced an increase in median prices of around 15%, and some grew by 20% or more. And it's the same in the Sydney and Melbourne property markets.

As you can imagine, some of these are the suburbs we targeted for our clients at Metropole last year. Of course not all properties in those top suburbs increased in value to that extent. You need to know the right type of property to look for.

By the way, there were just as many suburbs where the median price fell by over 10%, again showing that you have to be very selective in this market.

In the previous few years during the stronger property markets, even inexperienced investors did well. So did the speculators and the foolhardy. It seems everyone can make money from property at the top of the cycle.

But our property cycle has clearly moved on and the market conditions have changed significantly, with inexperienced investors or those who didn't stick to strong property fundamentals finding themselves in trouble. No surprises there — this happens every cycle.

Has the market bottomed?

If I'm suggesting you consider buying an investment property now, does that mean the markets have bottomed? Honestly, I have no idea — but the answer is probably no.

My question to you is: 'Are you buying "the market"?' Clearly the answer is NO!

You are investing in a property or a small number of wisely selected properties. This means that for astute investors there are some incredible opportunities around. There are currently quite a few very motivated, and at times desperate, vendors out there and this creates some top buying opportunities for long-term investors. I know we have bought some real bargains for clients in the last few months.

So back to the question: has the market bottomed out?

Probably not. My view of the property market could be summed up simply as follows:

- I feel very optimistic about the property markets in most of our capital cities in the medium to long term.
- I am certainly aware of potential short-term problems relating to the lack of confidence about the economy, affordability and poor market sentiment — which means that…
- You should be looking for property at the right price, in the right location, with the right rental income — property you would be happy to hold in your portfolio in the long term, and which you bought sufficiently below market price that, even if the market fell a bit further, you would still have bought well.

Just to make it clear, my strategy for this time in the cycle is to continue what I have been talking about and doing personally for years. That is:

Buy the right type of property — one that has some element of scarcity, which will always make it appealing to owner-occupiers (who push up the prices) as well as tenants.

Buy at the right price — which currently is below intrinsic value; the type of price where even if values drop another 5–10% (and I don't think they will in most areas) you will be covered.

Buy in an area that has always outperformed the market.

Buy a property with 'a twist' — for example a property to which you can add value. In times of flat capital growth you should manufacture some capital growth through renovations or redevelopment.

I posed the question at the beginning of this update — will this be a year of crisis or opportunity? When, in a year or two, you look at today's property markets in the bright light of hindsight, you'll probably say: 'I wish I'd bought a property then, at those prices!'

So are you ready to exploit the opportunities?

Michael Yardney is an author and expert in wealth creation through property. He is a successful property investor and, as a director of Metropole Property Strategists, he and his team help property investors identify, acquire and manage top performing investment properties to grow their wealth. As a property commentator he is frequently quoted in the media. You can subscribe to his free Property Update at www.PropertyUpdate.com.au.

Bulletin board

Ten-year members

As at 30 June 2011 the AIA has 365 ten-year members who will all be rewarded with an AIA pen. With the average length of membership just four years, we are delighted to honour these long-term members and hope they continue their membership. As they obviously understand, investing is a lifelong journey and even one piece of information gained at an AIA event or via networking could save them thousands of dollars.

Tracking and benchmarking investment performance

By Brian Spies

Performance figures are routinely quoted by fund managers, daily news bulletins and magazines for time scales ranging from days to months, quarters and years. What relevance do these figures have to the individual investor? Can they be manipulated to make an investment look better than it actually is? How should we treat volatility in returns with large positive and negative swings, and what time scales are most relevant? How can you, the investor, benchmark your own performance, and how do you compensate for cash additions or withdrawals made during the year?

This article contrasts basic record-keeping required for annual tax returns with techniques that an investor can use to measure investment performance — either their own or that of a fund manager. Simple tools can be used to track and benchmark investment performance to help evaluate whether you are doing a good job at meeting your goals. If not, you may be trading too much, or buying and selling at the wrong time, driven by emotion rather than by sound strategy.

Investment goals

The first step is to align your investment goal with your personal needs and risk profile, and then develop an investment plan. Some investors aim for capital growth and are comfortable with month-to-month volatility, while others require a reliable income stream and cannot bear the thought of capital losses, such as those experienced during the global financial crisis. A good financial planner can help you with these complex issues and suggest an appropriate range of investments to match your temperament.

Recording transactions

A wide range of tools, including custom spreadsheets, commercial packages and broker websites, are available for recording transactions for annual tax returns. Annual tax returns offer a convenient record of the investor's interest and dividend income and realised capital gains and losses for the year; but they are of limited use for evaluating investment strategies and investment performance.

Measuring performance

The annual cycle of calculating capital gains and losses for tax returns focuses the mind on a 1-year time frame ending at 30 June each year. But the realised capital gains and losses do not represent investment performance, nor can they be used to assess whether investment objectives are being met.

There are a wide range of free web-based tools for tracking share portfolios over arbitrary time periods. These include broker websites, Google Finance (www.google.com/finance), Trading Room (www.tradingroom.com.au), Morningstar (www.morningstar.com.au), InvestSMART (www.investsmart.com.au/my_portfolio/), the *Australian* (www.theaustralian.com.au/business) and *Sydney Morning Herald* (www.smh.com.au/business). Spreadsheets can be custom-made for other types of investment.

Creative application of these tracking tools can be used to better understand investment performance and overcome common pitfalls of investing.

Common traps

Human psychology and emotion play a much larger role in investment decision-making than is commonly believed. The groundbreaking studies of 2002 Nobel Prize winners Amos Tversky and Daniel Kahneman highlighted idiosyncrasies in the way people make decisions and handle risk. For example, subjects would make a 20-minute trip to buy a calculator for $10 instead of $15, but would not make the same trip to buy a jacket for $120 instead of $125, although the saving in both cases was $5. People are happier to spend a $50 note they find on the footpath than spend $50 from their bank account. These and similar observations go against conventional economic theory and spawned the burgeoning field of investment psychology. Examples of emotional traps for investors include the following:

Anchoring: basing an investment decision on irrelevant information, such as an arbitrary price or economic forecasts that have no predictive power

Loss aversion bias: not wanting to sell an asset at a price less than the purchase price, or recoup a loss before selling — common with real estate transactions as well as share trading

Representation bias: basing conclusions on too small a sample size, such as a short time frame or a subset of investments

Optimism bias: thinking you are getting market-like returns when you're not — selling winners early and letting losses mount.

Solutions

Most broker and other portfolio tracking websites allow the recording of multiple portfolios via the use of 'watchlists'. These watchlists can be used to benchmark separate portfolios and compare with common indices. When combined with simple spreadsheets, they provide a relatively straightforward means of tracking performance over a sufficient period of time to reduce statistical volatility. The following strategies may be useful:

Reset the price of shares in each portfolio to an arbitrary starting date such as 1 January or 1 July each year. This allows you to track the rise and falls of shares that you own without anchoring on the purchase price.

Benchmark against a common index. Enter one share of an index-tracking exchange-traded fund (ETF) such as STW (S&P/ASX 200 index), VAS (S&P/ASX 300 index), ILC (S&P/ASX 20 index), IVE (MSCI EAFE) or any other suitable index ETF. The dollar value of the single share will not impact on the total value of the portfolio but will enable a ready comparison of relative performance over any time scale.

Package investments into separate watchlists to track their relative performance; also track your total performance.

Use an appropriate mix of benchmarks aligned with your investment goal. Examples of investment goals include: 'I want to match or exceed the ASX 200 Accumulation Index each year,' or 'I want grow my investments by at least the consumer price index each year so that I keep up with inflation, but I do not want to see a decrease in my capital value over any 3-year time period.'

Adding or withdrawing funds from an investment portfolio

Most investors add or withdraw funds from their portfolios at various times during the year. It can be difficult to assess the impact of cash flow on investment performance. A simple formula for the 'time-weighted rate of return' can be easily entered into a spreadsheet to eliminate the distorting effect of cash entering and exiting the portfolio. Formulae for various levels of complexity are given in Wikipedia and finance texts, but for the individual investor the following methods work well.

The **rate of return** is given by

$$R = (M2 - M1) / M1$$

where M1 is the starting value of the portfolio and M2 is the ending value of portfolio over a given time period. R is usually expressed as a percentage.

When cash enters or leaves a portfolio, the time period needs to be divided into adjacent intervals with individual calculations made immediately after the cash flow. Such calculations can be quite complex, and for most investors a formula known as the Simple Dietz method is suitable. For a single time period, the rate of return is

$$R = (M2 - M1 - C) / (M1 + C/2)$$

Here, C is the total external cash flow in and out of the portfolio (cash flows out of the portfolio are negative and cash flows into the portfolio are positive). The C/2 assumes that cash enters or leaves the portfolio in the middle of the time period and is suitable for calculation of daily, weekly or monthly return.

Time-weighted rate of return. The time-weighted rate of return (TWR) is a measure of the compound return of a portfolio over a longer time period (such as a year) that takes into account cash flows in shorter time intervals (such as monthly). A reasonable estimate of the time-weighted rate of return is given by multiplying together individual returns R1, R2, R3 … calculated using the Dietz method for each time period to give

$$TWR = (1 + R1)*(1 + R2)*(1 + R3) \ldots -1$$

Academic and finance texts devote a great deal of space to discussing the most accurate formula for calculating true quarterly or annual returns that take into account cash flows at different times of the year, and whether arithmetic averages or geometric average rates of return are more appropriate. For the individual investor it doesn't really matter which formula is used as long as the same formula is used consistently to compare returns between investments.

Tracking investment performance of a share portfolio

These concepts can now be brought together in an example of tracking an investment portfolio and comparing to a benchmark index. In this case the benchmark is the ASX/S&P 200 accumulation index available from Standard and Poor's website, www.standardandpoors.com/indices/. S&P posts daily accumulation data the next day; it also has month to date, quarter and year to date figures.

Example spreadsheet

In the following example, month-end values are entered into a spreadsheet that tracks the performance of a self-managed super fund (SMSF) with three portfolios — a broker share trading account, fixed interest and a managed fund. Contributions are made at various times during the year, and pensions paid out periodically. Monthly return is calculated using the simple Dietz formula. The return for the financial year to date (FYTD) is also calculated and compared with the S&P/ASX 200 accumulation index.

In this example, over the 9-month period the accumulation index gained 17.2% and the SMSF gained 15.8%, slightly underperforming the index. Expenses such as accounting fees and taxes are paid from the broker account, thus the SMSF performance is net after fees and taxes. It is relatively straightforward to plot and compare the performance of other components such as the managed fund.

Note that since cash accounting is used rather than accrual, some months may be skewed in a positive or negative direction by items such as settlement of share transactions that span the end of one month and start of the next. These fluctuations will tend to cancel out when comparing year-to-year performance. Also, the shorter the time period the more volatile the performance is likely to be, as shown in the graph. Longer time periods are more reliable for assessing and comparing performance.

MONTH	START VALUE	JUL-10	AUG-10	SEP-10	OCT-10	NOV-10	DEC-10	JAN-11	FEB-11	MAR-11
MONTH END BALANCES										
BROKER	120,000	123,429	114,956	132,742	132,555	122,867	143,684	137,012	144,862	139,936
BANK	50,000	50,100	50,200	50,300	50,400	50,500	50,600	50,700	50,800	50,900
MANAGED FUND	50,000	52,512	51,028	49,845	52,193	51,937	50,837	51,927	52,973	61,926
TOTAL BALANCES	**220,000**	**226,041**	**216,184**	**232,887**	**235,148**	**225,304**	**245,121**	**239,639**	**248,635**	**252,762**
ADJUSTMENTS (EXTERNAL CASH FLOW)										
PENSIONS PAID		400	400	400	400	400	400	400	400	400
CONTRIBUTIONS		0	0	1,000	0	500	0	0	0	200
TOTAL CASH FLOW		**-400**	**-400**	**600**	**-400**	**100**	**-400**	**-400**	**-400**	**-200**
CHANGE IN BALANCE - EXT CASH FLOW "C"		6,441	-9,457	16,103	2,661	-9,944	20,217	-5,082	9,396	4,327
RETURNS										
MONTH RETURN	(Deitz calcul'n)	2.9%	-4.2%	7.4%	1.1%	-4.2%	9.0%	-2.1%	3.9%	1.7%
FYTD		**2.9%**	**-1.4%**	**6.0%**	**7.2%**	**2.6%**	**11.9%**	**9.5%**	**13.8%**	**15.8%**
ACCUM INDEX	30,415	31,702	31,476	33,056	33,774	33,299	34,519	34,582	35,395	35,632
% MTH CHANGE		4.2%	-0.7%	4.6%	1.8%	-1.1%	3.7%	0.2%	2.4%	0.7%
ACCUM INDEX FYTD		**4.2%**	**3.5%**	**8.7%**	**11.0%**	**9.5%**	**13.5%**	**13.7%**	**16.4%**	**17.2%**
RELATIVE PERF FYTD		**-1.3%**	**-4.9%**	**-2.7%**	**-3.9%**	**-6.8%**	**-1.6%**	**-4.2%**	**-2.5%**	**-1.3%**

Sample spreadsheet showing the monthly and year-to-date time weighted return of a self-managed super fund, and comparison to the S&P/ASX 200 Accumulation index.

Graph comparing the year-to-date returns of the SMSF portfolio with the S&P/ASX 200 accumulation index

Summary

By benchmarking the performance of investment portfolios against an appropriate index or professional manager, the individual investor is well placed to assess whether their investment strategy is working and they are on track to achieve their long-term goals. Is value being added or destroyed by active management? Underperformance of a portfolio may indicate the investor is trading too often or using an inappropriate strategy. It may be better to simply buy and hold an index fund, or invest via a fund manager.

Whatever the investment goal, it is important to apply an appropriate benchmark and time scale matched to personal circumstances. Benchmark data can then be used for periodic review and revision of investment strategies to meet the long-term goals of an individual investor.

Brian Spies is a member of the NSW Committee.

Tax notes

Trust streaming

By Linda Farmer and Dennis Eagles

Trusts are favoured by many investors because they allow some flexibility for income to be distributed to different beneficiaries. Streaming distributions makes it possible to pay lower tax overall by distributing to specific types of beneficiaries (e.g. those on lower marginal tax rates, non-residents, or those with capital losses). Some trust deeds force income to be streamed to specific type of beneficiaries (e.g. unit trusts or hybrid trusts). However, until recently the tax treatment of streaming has been unclear.

While trusts are common, the taxation of trusts is an extremely complex area of law and has been the subject of much litigation, including a recent landmark High Court case, *Commissioner of Taxation v. Bamford*. One issue that was not resolved by the court in the Bamford case, or in any other earlier decisions, was streaming different types of income to different beneficiaries and how beneficiaries are taxed on that income.

The government recently passed legislation to entrench in law the taxation treatment of distribution streaming. The new law allows franked distribution income and/or capital gains to be directed to specific beneficiaries. These changes apply from 1 July 2010 onwards.

The changes require the trustee to identify and document in the records of the trust:

- the amount of franked distribution income and/or the capital gain that is to be streamed
- the beneficiaries entitled to the amount
- each respective beneficiary's share of the amount.

The 'records of the trust' include the trust deed itself (e.g. default beneficiary entitlements under trust deed) and resolutions in respect of income distributions for the year.

The documentation must be completed on or before the following dates:

- 30 June if streaming franked dividends (although for year ended 30 June 2011 the ATO has given administrative extension to 31 August)
- 31 August if streaming capital gains.

What does this mean in practice?

- **Read your trust deed carefully.** If the deed doesn't allow for streaming, the changes will not apply to the trust and the various types of income must be proportionately distributed.
- **Review and update your deed.** To ensure the deed operates in an effective manner, consider having your legal adviser and tax accountant review it and, if necessary, vary it to provide sufficient flexibility. A good legal adviser will be able to determine the extent to which the deed can be varied without incurring other tax and/or stamp duty obligations such as resettlements.
- **Start distribution planning early.** It's now more important than ever to have distribution planning completed by 30 June each year. Identifying what comprises the income of the trust and who the potential beneficiaries are may take some time.
- **Ensure any necessary resolution is passed early.** If the deed requires a resolution to be passed before 30 June, a trustee should ensure that the resolution is passed by that date regardless of the timeframes available under the legislation.

Linda Farmer is a Manager and Dennis Eagles is a Director of the Wealth Advisory Services team in Grant Thornton's Brisbane office. This is a regular column aimed at providing general information on tax issues. Care should be taken when applying the basic principles to specific cases, as there are often exceptions to the general rules. If in doubt contact your tax adviser. If there are any specific topics you would like covered in future issues, please contact dennis.eagles@au.gt.com

Return of convertibles

By Brad Newcombe

Convertible bonds were relegated to the investment wilderness after changes to accounting and tax laws introduced over the past 10 years. Post-GFC, however, some companies (property companies in particular) are again issuing these securities.

Convertible bond

A convertible bond or note is a fixed income security that gives the investor the option of converting the bond to equity at a later date. The option to convert is at the discretion of the investor, not the issuer, so there is additional value in the security to the investor above that provided purely by the coupon payments.

A recent example of a convertible bond is that issued by property developer Peet. The Peet note issued in June 2011 is an unsecured, redeemable convertible note. The security pays a semi-annual fixed coupon of 9.5% per annum with a maturity date of 16 June 2016 (five years after issue). The investor also has the right to convert the bond into ordinary shares of Peet at any time after three months from the issue date, at a fixed conversion price of $2.25. Peet ordinary shares were trading at around $1.80 at the time of the issue of the Peet convertible note, meaning they share in the growth if the ordinary share price increases more than 25%. The value of this option means investors effectively receive a forecast return well above the coupon margin of 9.5%. Our estimate is that it brings the total forecast return on the bond to approximately 13.1%.

Theoretically, the upside on this bond is unlimited. Meanwhile the downside is limited. Assuming that Peet doesn't go broke over the next five years, and the ordinary share price doesn't track above the $2.25 conversion price, investors will still receive their $100 face value per note back on maturity and earn 9.5% on the way through.

Convertibles more speculative

The recent issuance of convertible bonds has been confined to more speculative companies such as property developers, mining and forestry companies. The reason for this is that these companies, which typically don't have an investment grade credit rating, prefer to lower their direct funding costs (coupon payments) by offering equity upside (i.e. potential for capital gain on conversion). Convertible bonds aren't so popular with investment grade companies, as the likes of Woolworths are currently able to issue into credit markets at relatively cheap rates and hence have no incentive to issue securities with equity upside.

FKP Property Group is another property company that has issued convertible bonds in 2011. At the start of this year, the company raised $125m of bonds for a five-year term paying an 8.0% coupon.

In recent years Goodman Group has also entered this market, but a little differently. Rather than issue a traditional convertible bond, Goodman Group issued a normal bond, but with free options granted. This means that investors will hold a bond to maturity while also having equity upside via the free options. This structure was also used by forestry company TFS Corporation, which has recently raised US$150m via a bond / free option security.

Summary

The post-GFC world has seen some issuers return to the convertible bond market. High-rated companies are still avoiding these bonds, as they can source funds more cheaply in traditional markets. However, convertible notes appeal to lower-rated companies, because the cash cost of the bond is cheaper than traditional securities, even if they are sacrificing some equity upside in their company to note investors.

Brad Newcombe is Director, Listed IRS and Fixed Income Research, with FIIG Securities Ltd.

Quantitative Easing – is it the answer?

By Scott Dixon

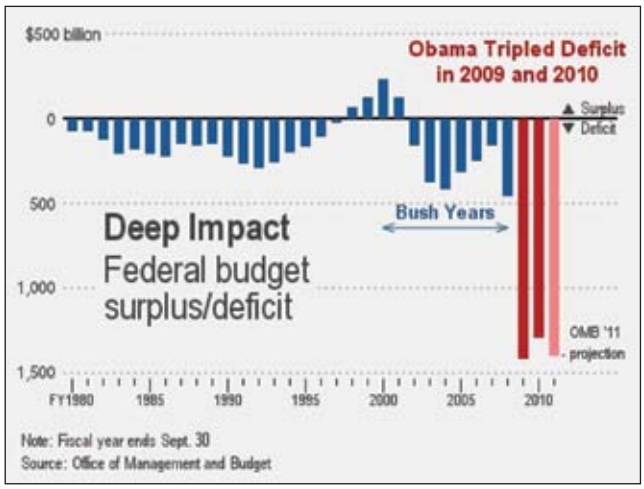
Quantitative Easing (QE) can be described as a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market via open market operations. Let's take a step back and look at the practicalities of how the US are doing this and what this means for markets around the world.

Firstly we need to differentiate between the US Government departments including the Treasury and the Federal Reserve. The Treasury is perhaps best known for its role in collecting taxes and managing Government revenue/expenditures. The Fed on the other hand acts as the central bank for the US, with a mandate to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Its primary method of accomplishing this task is through its influence on monetary policy – including interest rate cuts and quantitative easing during tough economic times.

Is the US financial system healthy?

The US Government and the Department of Treasury are running large budget deficits and expenditures currently *exceed* revenues by well over US$1 trillion, or 8.3% of GDP.

The Treasury is in charge of funding this shortfall, and this is done is by issuing "Treasury Bonds" to the market. The mechanics of such bonds involves an entity lending to the Government with the expectation of receiving a modest return, currently in the vicinity of 3.5% for long-dated Treasury Bonds.



The reason for such a modest return historically lay in the "safe haven" perception that the US Government will always meet its obligations and acts as a risk-free asset. However, the rate of return is a subject of manipulation and famed investors including Bill Gross and Warren Buffett have made headlines with their negative views on the U.S. Treasury bond markets.

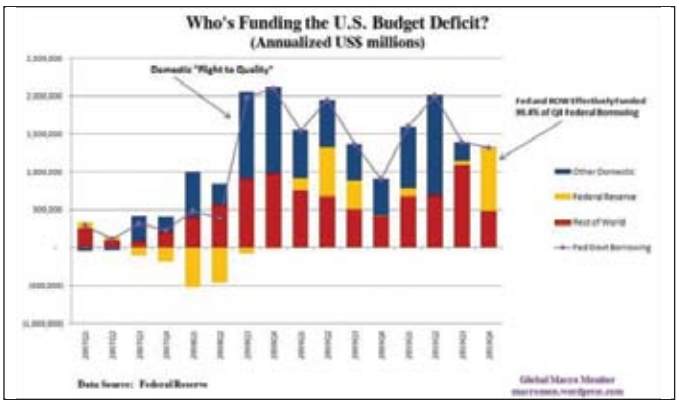
Who is currently funding the US Budget Deficit?

Broadly speaking, there are three potential buyers of these Treasury Bonds or Notes:

- Domestic institutions/investors;
- Foreign institutions/investors;
- The Federal Reserve as *a buyer of last resort*.

You will note that until Q4, 2010 the Federal Reserve had little impact in the purchase of Government issued bonds. This is because the Fed's first tranche of over $1 trillion in quantitative easing was buying "toxic assets" such as sub-prime mortgage backed securities from the banks and other major institutions.

Let's make this perfectly clear – the only way the Federal Reserve can afford to buy these toxic assets and other debt is by increasing the money supply – otherwise known as printing money.



Isn't printing money inflationary?

Interestingly, the net effect of the QE1 was non-inflationary because the banks/institutions were hoarding the cash the Fed provided, restructuring and repairing corporate balance sheets. However, this landscape is fast changing.

Under QE2, the Federal Reserve have drastically increased their purchases directly from the Treasury (via open market operations), which is manipulating the cost of debt, depressing Treasury yields and feeding the economy with excess liquidity. All else being equal, this will lead to inflation and is causing an artificially low US dollar.

In light of the above, US institutions have begun abandoning Treasuries and speculation mounts that foreign investors (such as the Central Banks of China and Japan) are increasingly considering alternatives, including gold. China has ambitions of increasing the Yuan's international role as a currency, and eventually removing the US dollar peg in favour of gold should not be discounted. This is particularly important because foreign investors in total account for over 30% of the $14.3 trillion in US Government debt on issue.

Should the Fed abandon QE cold turkey?

There is a big question mark over whether the economy is self-sustaining in its current form. One assertion is that we can expect a spike in Treasury bond yields to meet the imbalance between supply and demand, causing falls in US Treasury bond prices. The effect of such an event is an increase in the cost of debt for the US Government, which currently sits at a "manageable" $251 billion year-on-year (approximately 9% of revenues) but could spike to $500 billion or more if left unchecked. A downward spiral could ensue, similar to that seen in the Euro-zone.

The option remaining for the Federal Reserve is to continue hitting the printing press until the economy is self-sufficient. In this event, one could expect short-term growth in assets while investors utilise the excess liquidity. In the medium term we caution that a potential inflation spike will put upward pressure on interest rates and result in *stagflation*, a situation of high inflation with subdued economic growth.

The dilemma for the Federal Reserve

The above analysis doesn't leave much scope for optimism. Ben Bernanke has indicated that "We (the Federal Reserve) are going to continue to reinvest maturing securities, both Treasuries and MBS (mortgage backed securities), so the amount of securities that we hold will remain". This leaves over US$2 trillion on the Federal Reserves "balance sheet", far greater than the $700-800 billion held pre-GFC.

Eventually, the Treasury must tackle its enormous deficit and the Federal Reserve will unwind the excessive money supply by letting the bonds mature; which will both be contractionary to the US economy. Therefore the transition between stimulating the economy enough to make it self-supporting and unwinding before stagflation occurs means that the Treasury and Federal Reserves actions have never been more important.

Scott Dixon is Advisor, Lachlan Partners Wealth Management, Melbourne. This article is an extract from Investing Times, 15 May 2011 edition.

Results of the June 2011 members survey

During the month of June we undertook a comprehensive electronic survey of our members, with the primary goal of improving the services the AIA provides. We thank the approximately 400 members who responded. The survey was divided into the following five sections:

Personal profile

The majority of respondents (85%) were 55 or older, and 81% were male. More than half (53%) have retired, and two-thirds have more than 8 years' experience as investors; 69% have had no formal investment training.

Only 3% of respondents classify themselves as traders, although 23% describe their approach to investing as 'buying a financial asset with the intention of selling at a profit'; 62% invest mainly 'in order to produce future income', with a split between active (59%) and passive (39%) investing styles. A large majority (80%) seek a balance between achieving both capital growth and income, and 60% describe their aversion to investment risk as 'balanced'. Most members spend several hours a week on their investing activities, with 16% exceeding 10 hours.

The majority of respondents are fully DIY investors, with only 12% allocating more than 50% of their total portfolio to outside management. A third (37%) derive their annual income fully from their investments. Three-quarters (73%) have no form of debt associated with their investments. Only 13% of respondents use financial derivatives. Two-thirds are comfortable with their estate planning arrangements.

Investment portfolio

There are some interesting differences between respondents' current average investment asset allocation and what they consider ideal for the long term. Currently they hold 26% of assets in cash, but consider 17% ideal. Corresponding values for direct equities are 40% and 47% respectively, suggesting they are holding back funds they would normally commit to the share market.

They consider ideal a 14% allocation to direct property, 3% to property trusts, and only 6% to managed equities; 27% of respondents hold no managed investments at all. Only 48% of respondents hold a direct property investment, of which residential property is by far the most common.

Superannuation

Consistent with the age profile, the majority of the respondents' investment assets are held in the superannuation environment, with a roughly equal split between those held in the accumulation and the pension phases; 70% of respondents operate a SMSF, with 40% of these using an administrative service provider. Only 23% incur annual management costs of more than $4000.

Advice and resources

Only 22% of respondents use a financial planner. Of these, 72% meet costs on a fee-for-service basis. Ratings of the service provided are mixed, although 75% consider it to be satisfactory or better.

Almost all respondents use an online broker, by far the most popular being CommSec (61% of users) and E-Trade (24%). Of the 32% of respondents who use a full-service broker, the most common reason indicated is to obtain access to market research. Only 37% of respondents employ specialised software to assist their share investment decisions; of these, 72% use StockDoctor. A subscription to a web-based newsletter is the most popular information source, although subscriptions to financial magazines and newspapers are also common.

Investor attitudes

The results of this section of the survey will be presented in the next issue of *Investors' Voice*.

Members were also invited to comment on any issue they thought appropriate. Management is currently analysing those individual responses.

Bulletin board

AIA Conference, 1–3 September: early bird rate winners

Despite the market fluctuations, numbers for this year's AIA Investors Conference are well on track, and likely even to exceed expectations. As recently promoted, we offered all who had registered by 11 July the opportunity to enter a draw, and here are the prize winners.

First prize: Frank Taglieri, Sydney, NSW — 2 tickets to the conference dinner

Second prize: Carol Lake, Perth, WA — *Investing in the sharemarket* DVD set

Third prize: Bill Pursche, Scone, NSW — *An introduction to investing* DVD, *The Warren Buffett portfolio* by Robert Hagstrom and *Shares & taxation* by Jimmy Prince

AIA Conference, 1–3 September: *Headwinds facing the current market*

There are any number of significant potential events that could pose a threat to continuing world economic growth and the buoyancy of world stock markets. The situation in Greece, the debt situation in the US or any other unexpected world-shaking event could precipitate a bear market. Such events are what Nassim Taleb refers to as 'black swans'. For our final plenary session at this year's conference, renowned author Michael Kemp will ask three investors the tough questions:

- Brian Thomas, Head of Retail Funds, Perennial
- Ashley Owen, author and Chairman, Centric Wealth Advisers
- Bill Dodd, AIA Director, producer and presenter of the AIA Sharemarket Course.

Potential threats, the impact of a recession and collapsing overseas markets are just some of the topics to be discussed.

Perth share market investment courses: 23–24 September

Bill Dodd will travel to Perth to present two courses, both to be held at the Wembley Downs Tennis Club, corner Morden and Ednah Streets, Wembley Downs.

Course 1: An introduction to investing in the share market

Date: Friday 23 September, 9.00 am to 4.30 pm
Cost: $95pp (includes lunch and refreshments)
Handouts: Will not be provided on the day. All participants will receive a 40-page introductory booklet on investing and a copy of the PowerPoint presentation, supplied by email before the course.

Course 2: Strategies for improving investment success in the share market

Date: Saturday 24 September, 9.00 am to 1.00 pm
Cost: $45pp (includes morning tea)
Handouts: Will not be provided on the day. All participants will receive a copy of the PowerPoint presentation and a list of references, supplied by email before the course.

Investors can attend one or both of these courses. For more information visit the AIA website **www.investors.asn.au** or call the office on 1300 555 061.

Melbourne Trading and Investing Expo, 7–8 October

Trading & Investing Seminars & Expo
tradingandinvestingexpo.com.au

The AIA will participate in the **Melbourne Trading and Investing Expo**, to be held on Friday 7 and Saturday 8 October at the Melbourne Convention and Exhibition Centre. This expo provides us with a great opportunity to promote the association, and we hope you'll be able to help us man the stand over the two days. An email calling for volunteers will be sent out closer to the time.

Me and my portfolio

Seven principles for a *Creative Edge*

By Lee M. Spano

Over the years I have been trading and investing, the one key principle I have learnt is that to succeed consistently over time, one must have a 'creative edge'. That is, the ability to see things differently and to *time* things differently. This creative edge consists of a number of foundational principles — a *portfolio of principles* if you will, and these include:

1 Independent thinking

Decision-making should be based on research, insight and skill. It should not simply follow what we hear from the media, opinions from commentators or the financial industry. We must be able to assess such data and information *independently*, and act only if certain criteria are met which fulfil our particular trading or investment objectives. This comes from building a solid foundation of knowledge, skill and tools.

2 Deep planning

Many traders and investors still fail to plan, or if they do plan they fail to precisely follow an empirically tested one. I have found that deep planning is required, and this exists on two levels.

Level 1: The specific trading or investment plan. This level of planning is usually specific to a particular market, instrument or objective. For example, using covered call writing (CCW), preferably hedged on Australian or US blue chip stocks for monthly income. This plan will have the nuts and bolts of the trading system be it mechanical or discretionary, such as: entry, exit rules, position sizing formulae, and risk management rules.

Level 2: The strategic overarching plan. This is a broader plan with goals focused on times at least 5 to 7 years from the present. It consists of a collection of specific level 1 strategies to meet longer term objectives. For example, a CCW strategy may provide regular income from the equities market to help build a real property portfolio. Level 2 plans can therefore spread risk across investment vehicles.

3 Flexible approach and methodology

With globalised, electronically connected markets and economies, we have seen increased volatility, making markets more difficult, imprecise and at times nearly chaotic. Simple trend based systems, particularly after the GFC, have struggled. Macroeconomic issues, such as the European and American sovereign debt problems are a constant issue nagging at long term confidence. This environment means that one must have a flexible approach able to cater to changing market types and dynamics. A simple buy and hold strategy of blue chip stocks is likely to continue to struggle. Having a couple of *complementary* Level 1 strategies, which can be used at different times will help in this regard.

There should also be flexibility in regards to the tools and methodology used in your trading or investment systems. This may include both fundamental and technical analysis, and if the system is more longer term, then there may be greater weight to fundamental tools. Like markets, your methodology should be tested and personalised to meet your specific objectives. The key is to maximise two things in any system: first, positive mathematical and dollar expectancy, and second, the number of opportunities in your chosen market which fit your system. Consistent returns flow from these two variables.

4 Realistic expectations

The financial industry contains a great deal of often conflicting information, idle unresearched opinion and hyperbole. This can be confusing to the new and even experienced trader or investor. As we discussed earlier, building a solid foundation of skills and knowledge will facilitate independence of thought and decision-making. But we also need to be realistic about our expectations.

Broadly speaking, the best in the industry are able to produce somewhere between 20% and 30% ROI *consistently* over long periods of time. There is always a trade-off between risk and reward. If your expectations are greatly in excess of these industry benchmarks, then you should carefully investigate this trade-off in your system, or in the information being put before you. In addition, the higher your expectation, the greater the psychological pressure you will experience when trying to execute your system, particularly if it is a purely discretionary one.

5 A blend of art and science

The skill of investing or trading exists at the intersection of art and science. It requires a high level of both analytical and creative ability. The creative side is usually needed when building systems and seeing things that many do not. The analytical side is often used when testing, refining and in the discipline needed to effectively implement the system, particularly when markets are volatile.

6 The principle of *Kaizen*

Flowing from the third principle, namely flexibility, it is important one constantly reviews and improves their approach or systems. This principle of constant improvement is an ancient Japanese principle, known as *Kaizen*. If markets are dynamic, so too must be your approaches and systems.

The key is to know when to make changes and to what degree. Particularly in the financial markets, this insight only comes from long, careful testing and study usually of specific markets. For example, the EUR/USD will have a different dynamic character to the SP500. Therefore, if you choose to trade both markets in one system it should have specific rules for each market, or at least each market type. Regular reviews of your execution and results can provide the means for improving your systems or methodology.

7 Losses, risk and reward

Perhaps the hardest thing to come to grips with is the simple fact of loss, and sometimes regular losses. Losses are omnipresent in all markets and in all strategies. They flow from the uncertain nature of markets, human imperfection, volatility, and the inherent trade-off between risk and reward. Psychological tools can assist here.

For instance, seeing losses as 'overhead' or as a signal that you must learn something important are useful. But in any system, strong trade and risk management rules are paramount. Nowdays, when developing systems this is where I start. Technical entry and exit rules and other filters or optimisations come later. If the risk/reward parameters cannot be met, then perhaps you should consider another market or methodology.

As a professional private trader and investor, I approach all my activities as a business. I set high standards, employ strong systems and balance discipline with creativity and opportunity. This business is not an easy one, and is very different from conventional business models. Markets, information and the industry can be labyrinthine to navigate, but the most important journey starts and ends with oneself.

Lee M. Spano is an AIA member and a professional private trader and investor.

Calendar of events

Date	Event	Time	Venue	Topic
08-Aug-11	Adelaide Information Meeting	7.00 – 9.00pm	Enterprise House, Room 4, First Floor, 136 Greenhill Road, Unley	Investing in sideways markets
10-Aug-11	Gold Coast Information Meeting	9.30 – 11.30am	Robina Community Centre, Conference Room, 196 Robina Town Centre Dve, Robina	Investment strategies and estate planning for SMSFs
12-Aug-11	Toowoomba Information Meeting	10am – 12.30pm	Learning Network Qld, 27 Jellicoe Street, Toowoomba	Investment Outlook: Desperately seeking value
16-Aug-11	Melbourne Information Meeting	1.00 – 3.45 pm	Telstra Conference Centre, R1, L1, 242 Exhibition Street, Melbourne	Property-Residental outlook & LPT/REIT outlook
16-Aug-11	Perth Equities Discussion Group	7.30 – 9pm	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs	Equities Discussion Group
17-Aug-11	North Shore Information Meeting	7.00 – 9.30pm	The Chatswood Club, 11 Help Street, Chatswood	Shares to look out for, Julia Lee
01-Sep-11	AIA National Investors Conference	1–3 Sep 2011	Sofitel Sydney Wentwortth, 61-101 Phillip Street, Sydney	Wealth creation strategies
05-Sep-11	Canberra Information Meeting	7.30 – 9.30pm	Southern Cross Club, Woden (Check room allocation in foyer)	Equities Discussion Group
06-Sep-11	South Sydney Information Mtg	7.30 – 9.30pm	Miranda Community Centre, Wattle Room, 93 Karimbla Rd, Miranda	Equities Discussion Group
07-Sep-11	Brisbane Information Meeting	1.30 – 3.45pm	Broncos Leagues Club, Fulcher Rd, Red Hill	What's hot & what's not & The energy sector
09-Sep-11	Toowoomba Information Meeting	10am – 12.30pm	Learning Network Qld, 27 Jellicoe Street, Toowoomba	TBA
12-Sep-11	Adelaide Information Meeting	7.00 – 9.00pm	Enterprise House, Room 4, First Floor, 136 Greenhill Road, Unley	Using the right tactics at the right time – Alan Hull
21-Sep-11	North Shore Information Meeting	7.00 – 9.30pm	The Chatswood Club, 11 Help Street, Chatswood	TBA
23-Sep-11	Perth Sharemarket Course	9.00am – 4.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs	Introduction to investing in the share market
24-Sep-11	Perth Sharemarket Course	9.00 – 1.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs	Strategies for improving investment success in the share market
03-Oct-11	Canberra Information Meeting	7.30 – 9.30pm	Southern Cross Club, Woden (Check room allocation in foyer)	Canberra Discussion Group
04-Oct-11	Perth Information Meeting	7.30 – 9pm	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs	TBA
04-Oct-11	South Sydney Information Mtg	7.30 – 9.30pm	Miranda Community Centre, Wattle Room, 93 Karimbla Rd, Miranda	Equities Discussion Group
05-Oct-11	Brisbane Information Meeting	1.30 – 3.45pm	Broncos Leagues Club, Fulcher Rd, Red Hill	Property & Value investing with a margin of safety
10-Oct-11	Adelaide Information Meeting	7.00 – 9.00pm	Enterprise House, Room 4, First Floor, 136 Greenhill Road, Unley	TBA
12-Oct-11	Gold Coast Information Meeting	9.30 – 11.30am	Robina Community Centre, Conference Room, 196 Robina Town Centre Dve, Robina	Simple guide to protecting your portifolo/ Economic & market update
14-Oct-11	Toowoomba Information Meeting	10am – 12.30pm	Learning Network Qld, 27 Jellicoe Street, Toowoomba	TBA
18-Oct-11	Melbourne Information Meeting	6.30 – 9.15pm	Telstra Conference Centre, R1, L1, 242 Exhibition Street, Melbourne	Using the right tactics at the right time & the resources sector
18-Oct-11	Perth Equities Discussion Group	7.30 – 9pm	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs	Equities Discussion Group
19-Oct-11	North Shore Information Meeting	7.00 – 9.30pm	The Chatswood Club, 11 Help Street, Chatswood	Using the right tactics at the right time – Alan Hull
28-Oct-11	Melbourne One Day Seminar	9.00am – 4.30pm	Telstra Conference Centre, R1, L1, 242 Exhibition Street, Melbourne	Navigating your way in troubled times
28-Oct-11	Sydney One Day Seminar	9.00am – 4.30pm	Tattersalls Club, 181 Elizabeth Street, Sydney	SMSF & Advanced estate planning
01-Nov-11	Perth Information Meeting	7.30 – 9pm	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs	TBA
01-Nov-11	South Sydney Information Mtg	7.30 – 9.30pm	Miranda Community Centre, Wattle Room, 93 Karimbla Rd, Miranda	Equities Discussion Group
02-Nov-11	Brisbane Information Meeting	6.30 – 9.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill	AGM & Fundamentals & technicals of good stock selection

NB. Topics subject to change.

AUSTRALIAN INVESTORS ASSOCIATION ABN 75 052 411 999

Investors Helping Investors

The Australian Investors Association (AIA) is a national, non-profit, independent association of investors dedicated to helping other investors achieve their goals through education and advocacy.

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