Market volatility

Many investors become concerned when volatility occurs in global financial markets – particularly about the impact on their superannuation and other investments. In times like these, it is important to understand the causes of market movements and how to minimise your risk.

Why do markets move so much?

Markets are influenced by many things – industrial, economic, political and social factors can all have an impact. For example, consumer and business confidence affect spending and therefore company profits. Global trade and production naturally affect economic growth. Poor political and fiscal decisions in some countries may lead to a flow-on effect in other countries that are owed money. And of course, natural disasters can cause major damage to any economy with no warning. During times of market volatility, it's important to remember one of the fundamental principles of investing – markets move in cycles.

Current economic outlook

Global share markets have experienced considerable volatility since the global financial crisis, although there have been bouts of stronger returns. Volatility has been driven by factors including the impacts of COVID-19 and associated supply chain issues and the Russian invasion of Ukraine.

These factors have flowed into the Australian share market where a number of home grown issues have also created volatility. These include increased inflation, rising interest rates and political uncertainty.

What is the effect of market movements on investment returns?

The table below shows the effect of market volatility on different asset classes for one, three, five, 10 and 20 year periods. Looking closely, we can see over 20 years, returns across all asset classes are positive.

Asset class returns as at 31 December 2022

Annualised Performance (%)	1 year	3 years	5 years	10 yrs	20 yrs
Australian equity	-1.08	5.55	7.11	8.66	8.89
International equity	-12.08	6.74	9.26	13.75	7.15
Australian REITS	-20.06	-0.83	3.79	8.48	5.39
Australian Fixed Interest	-9.71	-2.87	0.54	2.33	4.32
International Fixed Interest	-12.28	-3.17	-0.22	2.33	5.11
Cash	1.25	0.55	1.01	1.67	3.5

Source: FE Analytics

What is the effect of market volatility on super funds?

In times of market volatility your super balance may decline, but it is important to remember that markets move in cycles. Volatility is a natural part of the economic cycle. Markets are influenced by a range of factors and are inherently unpredictable. History demonstrates that over the long term, the general trend of share markets has been upward.

Don't lose sight of the bigger picture

Super is a long term investment. Shares, which usually form a large part of most balanced super accounts, are also generally a long term investment. They are designed to provide capital growth over a period of five years or more. Think in years, not days. The time frame for super may be 20 years or more, so short term volatility shouldn't diminish the long term potential of your investments. Growth assets (such as shares) tend to fluctuate in the short term, but have historically provided excellent returns for investors over the long term.

When share markets fall in value, it may be tempting to sell up. However, trying to time the market by selling now and buying back later is a risky strategy that rarely results in investors coming out ahead. By taking a long term view of investing, you can ride out any short term fluctuations in the market and take advantage of growth opportunities over the long term.

Diversification

Diversification is one of the most effective ways of managing volatility. It can help deliver smoother, more consistent results over time. Your investment may benefit by being spread across a variety of asset classes, including shares (domestic and global), fixed income, cash, direct and listed property and alternatives. This diversification should help soften the effects of any share market falls as some asset classes often tend to do well whilst others are struggling. Also, spreading your assets around means you are less reliant on any one asset class at any particular time.

Understand your risk profile

All investments carry some risk. How much risk you're willing to accept will be influenced by your financial situation, family considerations, time horizon and even your personality. If market volatility has caused you to reassess the way you feel about risk, it's important that you see your financial adviser to discuss any necessary changes to your financial plan.

Understanding the implications of withdrawing

Before you withdraw from an investment you should understand all the implications, risks and costs involved.

- **Crystallising losses.** If the value of your investment is falling, you are technically only making a loss on paper. A rise in prices could soon return your investment to profit without you doing anything. Selling your investment makes any losses real and irreversible.

- **Incurring capital gains tax (CGT).** Make sure you know what your CGT position will be before selling any asset.

- **Losing the benefits of compounding.** If you're thinking about making a partial withdrawal from an investment, remember that it's not just the withdrawal you lose, but all future earnings and interest on that amount.

Key takeaways

Keep in mind that:

- Super is a long term investment designed to generate sufficient money so you can enjoy your retirement.
- Diversification is an important part of a long term super investment strategy. To create the lifestyle you want in retirement, it may be necessary to invest in growth assets like shares so that your returns stay ahead of tax and inflation.
- It may be beneficial to ride out the bad times in order to achieve long term growth.
- Your financial plan was designed exclusively for you to suit your investment objectives and risk profile. It's important to stay focused on your long term goals.