The tricks of canny investing

MONEY MATTERS

Mark Williams

The title of this week's article sounds more like a tropical storm warning than a warning to investors, which may be appropriate given that TINA can be just as devastating on your wealth as a category-five hurricane when making landfall.

TINA is the acronym for "There is no alternative", meaning there is no other place to invest, but in equities; that is, if you are targeting an inflation plus return on your investment.

This, thanks to unprecedented central bank intervention collectively known as financial repression, made up of quantitative easing (QE), zero-interest rate policy (ZIRP) and now NIRP (negative interest rate policy). This is all for the purpose of trying to stimulate global growth, which incidentally hasn't worked to-date, but that is beyond the scope of this article.

As a developed market saver you can no longer earn a return from cash and/or bonds. You literally have no alternative but to invest in property and/or equities to generate a return on your savings.

This is a step-up on the risk/return curve versus traditional risk-free assets; and this is where the danger lies, as investors take on inappropriate risk budgets, which are out of sync with their personal risk appetites.

Risk is the most quoted topic when it comes to investing, yet the most misunderstood. The logical definition of risk is "loss of capital". However, loss of capital can be classified either as permanent or temporary.

Permanent loss of capital is associated with fraudulent schemes, overpaying for an asset or investing in a business, which goes bankrupt. As a reasonably informed investor, it is fairly easy to avoid permanent loss of capital by investing in regulated savings vehicles managed by experienced managers.

The tricky part is not turning a temporary loss into a permanent loss; let me attempt to explain further.

Temporary losses are associated with volatility of return most commonly defined as risk. The fact that the annualised volatility of equities is 17,9% vs 6,9%, for bonds, implies a far greater risk when investing in equities over bonds.

The wider range of returns for equities is due to irrational investor behaviour driving stock markets well below the underlying fundamental value or well above depending on short term sentiment.

Investors generally accept the greater volatility associated with equity investing, understanding that this is an inherent characteristic of equity investing the price you pay for real inflation plus returns. The most important aspect of equity investing is ensuring the you have a long enough time/investment horizon to sit out any down-turn.

Sounds easy, but the problem comes when you have a serious draw-down, better known as a crash. This is when the investors' fortitude is tested to the limits.

It's a complete different story when your life savings halve in value; keep in mind when this happens the news is usually very bad. As investors we have to be honest with ourselves, because if you are not able to stick it out you risk turning a temporary loss into a permanent loss.

Don't avoid TINA. You need equities to protect yourself against inflation, but ensure you have the emotional risk tolerance to withstand a "storm" and match your income/capital requirements with an appropriate time horizon.

The "storm" always passes, you just need to sit it out!