

# The dangers of investment switching

Market conditions in the last two years have been extremely volatile and understandably many members found these conditions extremely hard to cope with and were driven to think about changing their investment strategy. Our message to members has always been to think of the long term when contemplating an investment switch and not to react to short-term market movements but we understand how difficult it can be when you are facing losses in your account balance.

In order to give you some concrete examples of the effects of investment switching we have collected real data from member investment switches over the last two financial years and have taken three member scenarios to demonstrate the positive and negative consequences of switching your investment strategy. We have changed the names and we have also simplified the examples so that they exclude personal and employer contributions but the underlying information is real. The period we're going to cover is between November 2007 and October 2009.

So to start I'd like to introduce you to Maurice.

## Maurice

Maurice has been with LGS for more than 30 years and having left employment with local government in 2005 at the age of 60, he had an account balance of \$550,000 as at November 2007. In his semi-retirement he devoted a good amount of time to following what was going on in investment markets and he had actually begun to become nervous about the ongoing market rally in 2006. However he only decided to make a switch in November 2007 which turned out to be a wise move.

Moving to Cash at that time meant that he missed out on much of the turmoil caused by the global financial crisis. From November 2007 to October 2009 his benefit made a 9.5% positive return which meant that his account grew from \$550,000 (in round figures) to \$602,250 during this period.

Of the three people we're going to look at Maurice made the best return but we do have to point out that Maurice was only one of a handful of members who actually switched at this time. Even the most astute investment analysts find it difficult to 'time' the market accurately, that is pick and choose when it is best to move in and out of asset classes to get the best return. Most of those who made the switch to Cash in this period did so much later and this brings us to Stephanie.

## Stephanie

Stephanie, age 53, left local government employment some time ago and then returned which meant she had two accounts. The older one was deferred, had a balance of \$315,000 in November 2007 and the investment strategy was Growth (formerly Trustee Selection). The other account was for her employer contributions. Stephanie did not pay much attention to financial news and felt that she could tolerate short-term negative returns in her deferred account because contributions were still being made to her active account.

Stephanie however found her 2007/08 statement quite troubling, as it showed a negative return of 8.8%. However she decided to stick to her guns as she had experienced negative returns before and they had been quickly followed by a substantial rebound. She decided though to keep a closer watch on her super in the future.

The financial news in late 2008 became increasingly bleak and then in February 2009 she received her interim statement which showed a negative return of 18.9% for the six months to 31 December 2008. The size of the investment loss, the bad news in the media and the fact that the downturn seemed to be sustained really worried her and so she decided that she could no longer expose her investment to further negative returns and switched to Cash on 2 March 2009.

Unlike Maurice, Stephanie was in good company - 36% of all members who switched to Cash during this time did so in



February and March 2009 and 61% of all switches occurred between November 2008 and April 2009. The reason for pointing this out is that it was in March 2009 that a sustained market rally began and Cash went from being the best performing strategy to the worst for the rest of 2009.

Stephanie's switch crystallised the losses (meaning that they now had become real losses) she had made in Growth and she then earned the Cash return to October. This translated to a loss of almost 30% between November 2007 and October 2009, meaning that her account balance fell from \$315,000 to \$220,000 in round figures.

Stephanie, like many members, moved to Cash just as markets were starting to recover and so missed out on the upswing. This leads us to the final example.

## Brian

Brian, age 49, is still actively employed in local government and as he is naturally a bit of a risk-taker he decided early in the financial crisis that he would stick to his chosen investment strategy, Balanced Growth, and wait out the storm. His account balance in November 2007 was \$345,000 and the following calculations exclude employer contributions during this period.

He had a few nervous moments in late 2008 but never really changed his mind and was eventually reassured as the positive return in March 2009 was repeated in the following months.

Brian's steadiness didn't save him from negative returns. He still suffered a loss of more than 19% between November 2007 and October 2009 meaning his account balance fell from \$345,000 to \$280,000 but he did considerably better than Stephanie whose courage failed her at just the wrong moment.

## So what are the lessons to be drawn from this?

While choosing a strategy is ultimately a personal decision there are a few observations to make.

First, it is extremely difficult to 'time' the market. As our research shows, most members don't successfully 'time' their investment switches. While Maurice's example shows it is possible to get the timing right, statistically he was the exception. Most members who made an investment switch during the period did so around the same time as Stephanie and suffered similar negative consequences.

Second, you should choose a strategy based on your personal circumstances and a long-term perspective. Your decision should take into account the risks attaching to that style of investment and you shouldn't react to short-term events.

Third, if you are unsure about what to do you should consult a financial planner. Financial planners can't predict the future, but they can help you match your financial needs, personal circumstances and risk profile to the most appropriate investment strategy.

For this reason, Local Government Super provides a no cost financial planning service so if at any time you are considering a switch of investment strategy, we recommend that you call the team on 1300 369 901 to discuss it first.



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