

How best to protect those precious assets

Safety should be a priority, understandably, for most small investors, writes **Jason Krupp**.

IT'S been next to impossible to escape the flurry of headlines warning that the next global recession is on our doorstep, with the chickens of the financial crisis coming home to roost once again. And while institutional investors may have the luxury of talking up buying opportunities, for the average retail investor the challenge is finding a safe port ahead of the impending storm.

These safe havens do exist, investment advisers say, and by adopting the right strategy and bulking up on an understanding of products in the market, the average person in the street can protect his or her nest egg. Here are seven golden rules to safe haven investing:

1. Make a plan and stick to it

Ben Brinkerhoff, general manager at financial adviser firm Bradley Nuttall, says the first step involves setting an investment goal, be it saving for retirement or putting together the deposit on a house, and then sticking to it.

That will determine the time horizon of your investment, and therefore how risky it is. The longer out the timeline, the less susceptible investors are to short term bouts of volatility like a recession, and the more likely they are to remain in higher risk markets based on the view they will rise in future.

The corollary is that the shorter the investment horizon, the less risk investors can absorb and so the more likely they are to choose defensive assets and products.

"What we find is that if you don't

have a plan, then you are more susceptible to making kneejerk reactions," Brinkerhoff says.

"You shouldn't be making decisions in terms of market activity but in terms of what you want to be using the money for."

2. Diversify, diversify, diversify

Investors should have a diversified portfolio so that the losses in one asset class can be limited by the relative performance of another, says Ross Cuthbert, an adviser at Craigs Investment Partners.

Some asset classes, such as government bonds and equities, act as a natural insurance for each other.

"The golden rule is to spread your money around, with no more than 10 per cent of your portfolio in any one security," Cuthbert says.

3. Pushing product

With these principles in place, the next step is to consider which defensive asset classes to add to your portfolio.

Unsurprisingly, Cuthbert and Brinkerhoff both think retail investors should seek the help of a registered professional, particularly one who charges for advice rather than claiming a commission from the financial service providers.

While the former may cost you some upfront cash, the choices you'll be presented with are likely to be in your best interests rather than aimed at maximising your adviser's returns.

Even with a comprehensive plan, there are some more defensive asset classes and products out there that investors may want to consider adding to their portfolio.

4. Cash is king

Stuffing money under the mattress is a time-honoured way of keeping your money safe and in volatile times even the most sophisticated investors prefer the feel of cold hard cash over



complicated financial instruments.

So much so that when ratings agency Standard & Poor's downgraded the US credit rating in early August, triggering a flight of capital in the market in the process, retail banks in New York were

charging investors upfront fees to park their cash in their vaults.

Plus, in New Zealand investors get peace of mind knowing that these funds are protected under the extended Crown Retail Deposit Guarantee in the event of

a Lehman Brothers-type collapse, provided their deposit taker is covered by the scheme.

Brinkerhoff, however, cautions that interest generated on cash is very low; in many cases investors are slowly losing money as inflation outstrips interest earnings on their nest egg.

According to the interest.co.nz website the best rate being offered on a 12-month fixed deposit is about 4.5 per cent, whereas New Zealand's annual inflation rate stood at 5.3 per cent as of June, netting an investor a loss of \$8 for every \$1,000 they have in the bank over the course of a year.

5. Bonds but not James Bond

Bonds are a famed safe haven asset offering investors protection against volatility by gaining value in uncertain times as they are generally backed by assets in the case of companies or by explicit government guarantees.

However, Cuthbert warns investors should be cautious about these assets as the volatility of the past three years means these securities are currently priced at a premium.

Additionally, the yields or interest payments on government bonds are so low that they are often outpaced by bank rates, and should only be used by investors who are extremely risk averse, such as retirees.

6. Equities, yes they're safe-ish

Given that the Standard & Poor's 500 Index has lost about 4.4 per cent so far this year, and the NZX 50 Index is just about square, it seems counter logical that equities are seen as a safe haven asset.

However, it's all about choosing the safest pockets as there are defensive markets, defensive sectors and defensive equity products.

No other asset class consistently outpaces inflation as effectively as the stockmarket. New Zealand's NZX 50 Index is one of the least in the world

affected by the benchmark Standard & Poor's 500 Index in New York and so volatility is felt far less severely here than in the States.

Additionally, within the local market there are also several companies whose dividend payments outpace bank interest rates and inflation when calculated as a percentage return on investment.

High dividend stocks also have a degree of income security as companies tend to keep dividend payments stable even while stock prices may fluctuate.

"Obviously you take on equity risk when you do that, but utilities tend to be less volatile," Cuthbert says. "So for income investors these options are not a bad place to look."

7. Thinking outside the box

Other investment options include index tracker or exchange traded funds. These funds acquire a portfolio of stocks that proportionally matches the composition of an index such as the NZX 50.

Because they aren't actively traded the fees involved are considerably lower than managed funds.

This means investors are diversified within a market as returns are based across the total stock exchange rather than on the performance of a single stock.

And by investing in exchange trade funds across different markets, investors can get the risk profile which matches their tolerance level, Brinkerhoff says, with several thousand products on offer.

"You should never try and cherry pick equities; it rarely makes sense to concentrate your portfolio," he says.

ETFs also offer the advantage of being denominated in units.

That means provided you invest a consistent amount on a monthly or quarterly basis, in a downturn you acquire more units for your money, which potentially nets you more upside when the market recovers.

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