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LESSONS FROM 2014

A combination of the blanket news coverage of economic worries, the associated information avalanche we are now exposed to and our innate fascination with crises is likely making us worse investors. We're more fearful, more jittery and more focused on the short-term. With the year drawing to a close, now is a good time to reflect on some key lessons from 2014.

Lesson 1: Turn down the noise

While not to deny the current worry list, it's really nothing new. The global economy has had plenty of difficult phases in the past. And it got over them.

There are four things investors should remind themselves of:

- Shares and other growth assets have historically climbed a wall of worry and they will most likely continue to do so.
- Turn the volume down on the 'news' front, i.e. consume less of it.
- Adopt a long-term strategy and stick to it.
- The best opportunities in investing often arise when many are engulfed by gloom and doom and the market is cheap.

DR SHANE OLIVER
Head of Investment Strategy and Chief Economist

Lesson 2: Don't ignore dividends

Dividends provide a great contribution to returns, a degree of protection during bear markets and a great income flow. Investors should always allow for them in their investment decisions.

> **"While not to deny the current worry list, it's really nothing new."**

Lesson 3: Be wary of herd mentality

While it may feel uncomfortable, successful investing often requires going against the crowd – particularly when the crowd is at extremes of bullishness and bearishness. Various investor sentiment and positioning surveys provide a guide.

LOOKING AHEAD: 3 THEMES TO WATCH

Secular investing looks ahead – beyond just the next few years – to investigate the themes and directions that will shape the future world. We explore three key themes which may provide exciting investment opportunities in the future.

Education

With the future likely to be more dependent on an increase and improvement in technology and new concepts, education is likely to be a key growth area. This will apply not only to school student and university graduates but also to the working population who will be required to keep their skills up-to-date or acquire new skills on an ongoing basis.

> **"It's important to see through the short-term mist...to capitalise on emerging investment themes and opportunities."**

The energy revolution

A growing global population coupled with an insatiable demand for energy, will mean that new sources of energy will be a major growth area. Companies specialising in alternative energy production are expected to undergo a sea change in the coming years as the world shifts to a low-carbon economy.

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Ageing demographic

Falling birth rates and improvements in health care have meant we are all living longer. Looking forward, this has implications for the pharmaceutical, medical and health care industries, especially where this can add to the quality of life and not just the nominal age at which we die.

Final thoughts

For those investors who are prepared to take the long-term view and who want to be suitably placed in the next 10, 20 or even 30 years, it is important to see through the short-term mist; paying less attention to short-term ups and downs in order to capitalise on emerging investment themes and opportunities.

MARKET SEASONALITY: THIN MARKETS AND WHAT THEY MEAN FOR INVESTORS

Markets are often spoken of seasonally - as if akin to weather. Common themes include 'The Santa Claus' rally, 'Sell in May and go away', and even anniversaries of previous market crashes, such as the 'Black Monday' October 19, 1987 market plunge. We discuss market seasonality and the importance of screening out short-term market noise.

Are seasonal patterns real?

Market seasonal patterns, to the extent that they exist at all, are by no means guaranteed, and in most cases are not investable. Regardless of this, the behavioural nature of investing can see markets becoming relatively 'thin', that is, lacking in buyers and sellers over some of these so-called seasonal periods. Thin markets, due to a lack of trades, can create large differences in the quoted buy and sell prices (spreads), which in turn tends to increase price volatility.

Liquidity can also be a real risk in thin markets. It is perhaps most palpable to self-funded retirees with little or no cash reserve, forcing them to sell units at distressed prices in order to fund their income needs. That's why advisers often emphasise the need to maintain an adequate cash reserve.

> "Liquidity can be a real risk in thin markets."

What can investors do?

We suggest investors screen out short-term market noise and remain focused on their investment strategy. That's because, seasonal volatility can actually present investors compelling opportunities to buy quality assets at a discount to what they are worth. For example, investors will actually receive a greater number of units in their fund during a downturn. Counterintuitive as it may be, for those with a longer investment time horizon, bearish markets can actually assist in the creation of long-term wealth.

Final thoughts

When we read the paper, watch the news or check a business website, we seem to be inundated by a plethora of reports attempting to predict what the share market will do over the short-term. This festive season, whether the market 'tis in the season to be jolly' or not, it is important to remain focused on a sustainable investment strategy.

LIFTING THE HOOD ON RESPONSIBLE INVESTING

We lift the hood on responsible investing and explore how it can help investors make better informed investment decisions.

> "ESG issues can often tell investors something about the quality of management."

What is responsible investing?

Responsible investing considers a broad range of issues that may have a material impact on the risk and return characteristics of investments. These issues may be driven by existing or future regulations, reflect issues of significant societal concern, or pose potential operational, financial, strategic, reputational or systemic risks.

To invest responsibly, we consider a number of factors:

Environmental: Natural resource use and degradation (e.g. water scarcity), waste, pollution, greenhouse gas emissions, climate change, clean technology products and services, environmental management practices.

Social: Human capital, workplace health and safety, labour relations and standards, human rights, demographic changes, supply-chain and community impacts.

Governance: Board composition and independence, executive remuneration and incentive plans, corporate accountability structures, compliance, negligence, bribery and corruption, conflicts of interest and related-party transactions, shareholder rights, accounting and audit quality.

SALLY BOONE
Senior Portfolio Manager,
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What does this mean for investors?

In-depth analysis of these factors can identify mispriced securities and opportunities for outperformance for investors. While the direct earnings impact of individual Environmental, social and governance (ESG) issues might be small, the way a company deals with its ESG issues can often tell investors something about the quality of management.

Final thoughts

There are links between an organisation's environmental and social impacts, the quality of its corporate governance, and its long-term business success.

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Economic indicators

Gross domestic product (annual rate %)*	Latest	Current	Previous	1 year ago
World (IMF/OECD)	31 Dec-2013	2.9	n/a	3.1
Australia	30 Sep-14	2.7	2.7	1.9
China	30 Sep-14	7.3	7.5	7.8
European Union	30 Sep14	0.8	0.8	-0.3
United States	30 Sep-14	2.4	2.6	2.3
Inflation (annual rate %)*	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia	30 Sep-14	2.3	3.0	2.2
China	31 Oct-14	1.6	2.3	3.2
European Union	30 Nov-14	0.3	0.4	0.9
United States	31 Oct-14	1.7	2.0	1.0
Official interest rates (%)*	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia	30 Nov-14	2.50	2.50	2.50
China	30 Nov-14	2.61	2.91	3.73
European Union	30 Nov-14	0.05	0.15	0.25
United States	30 Nov-14	0.25	0.25	0.25
Bond yields (%)	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia 3Y	30 Nov-14	2.39	2.63	3.06
Australia 10Y	30 Nov-14	3.03	3.29	4.22
United States 2Y	30 Nov-14	0.47	0.49	0.28
United States 10Y	30 Nov-14	2.16	2.34	2.74

Exchange rates

Official interest rates (%)+	Latest	Current	3 months ago	1 year ago
Australian Dollar / Chinese Renmimbi	30 Nov-14	5.2448	5.7457	5.5686
Australian Dollar / Euro	30 Nov-14	0.6846	0.7101	0.6712
Australian Dollar / Great British Pound	30 Nov-14	0.5450	0.5632	0.5579
Australian Dollar / Japanese Yen	30 Nov-14	101.2976	97.1636	93.5468
Australian Dollar / United States Dollar	30 Nov-14	0.8535	0.9353	0.9139

Share market analysis

Sharemarkets (in local currency)	5yrs (%pa)	3yrs (%pa)	1yr (%)	3 months (%)	1 month (%)
Australia: S&P/ASX 300 Accumulation	6.8	13.4	4.0	-4.5	-3.2
Germany: DAX Accumulation	12.2	17.9	6.1	5.4	7.0
Global emerging markets : MSCI Accumulation (AUD)	12.5	23.5	16.6	9.5	5.1
United Kingdom : FTSE 100 Accumulation	9.1	10.8	4.7	-0.8	3.1
United States : S&P 500 Accumulation	16.0	20.9	16.9	3.7	2.7

*Data is most current available
+Rates are expressed as 1 Australian Dollar
(IMF/OECD) purchasing-power-parady