Investing in Times of Market Volatility

Recently, there has been a lot said in the media about the Australian share market volatility. Unfortunately, many of the headlines and reports have appeared unbalanced and may have created uncertainty amongst investors. Some investors have also expected that the unprecedented market highs they have enjoyed for many years would continue.

One of the main messages that should have had more attention is the need to remain committed to a long term investment strategy. This is because history tells us that markets have always recovered in the past and the size of the upturns in the market have outweighed the size of downturns*.

So you can have a clearer picture of what's happening we take a closer look at what has caused the Australian share market volatility and put this into some context.

What has been happening in the Australian share market?

In early November the Australian share market reached a new high. The S&P/ASX All Ordinaries share price index reached 6853 points, 27% higher than it was a year earlier. Since then, the market has been volatile and has fallen in reaction to overseas market conditions and economic uncertainty.

It's important to view this volatility in context with the recent performance of the Australian share market. Over the 3 years ending 31 December 2007 the S&P/ASX300 All Share Accumulation Index has returned 21.7% p.a.

In times of market volatility it's natural to feel nervous, however, it's even more important to remain committed to your long term investment goals.

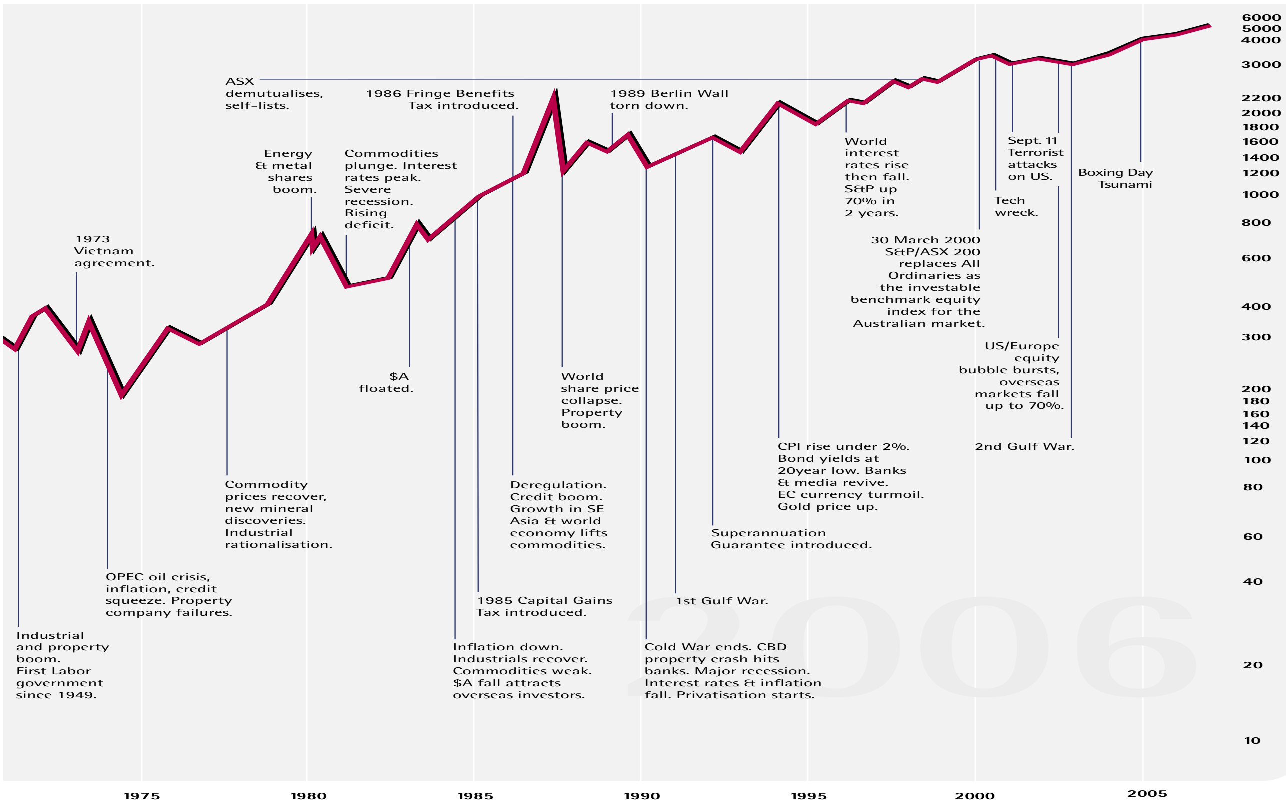
Share markets will suffer downturns but have historically climbed back to new highs over the longer term and it's also important to remember that markets move in cycles.

How have overseas markets affected us?

Various market commentators believe that two main factors have influenced Australian markets:

- the credit crisis in the US, and
- fear of a US recession.

These factors have caused some investors to sell more assets than usual, which has resulted in lower share prices and increased market volatility.



Source: Australian Securities Exchange, Australia Share Price Movements, 2006

* Past performance should not be taken as an indication of future performance.

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What is the credit crisis?

The US credit crisis has been caused by sub-prime lending. This type of lending occurs when loans are granted to people who may have difficulty meeting repayments and also those who would not have qualified for a loan under normal lending requirements.

Under economic pressure, many of these loans moved into default which means the overseas lending institutions lost money. This led investors to start selling their shares in these institutions as they were nervous and uncertain about the company's prospects.

In addition, large US investment banks have reported lower profit results due to their exposure to sub-prime investments. This has created uncertainty amongst investors which has led to increased share market volatility.

Unfortunately, this uncertainty has spread to the Australian share market which is why we are experiencing more volatility.

What's the outlook for the Australian share market?

Despite the recent market volatility we are experiencing, it's important to remember that the Australian economy remains strong. In fact, the Reserve Bank has lifted official interest rates in an attempt to slow down our strong growth.

If we look ahead at the Australian share market, we do expect further volatility which means the market will go up and it will also go down.

The volatility of the share market, in light of the strength of the Australian economy, may appear strange, but markets are affected by investor sentiment in the short term and so far in 2008, investors have been very uncertain.

The main thing to keep in mind is to stay focused on your long term investment goals and not get too caught up in the short term market volatility.

Learning from experience

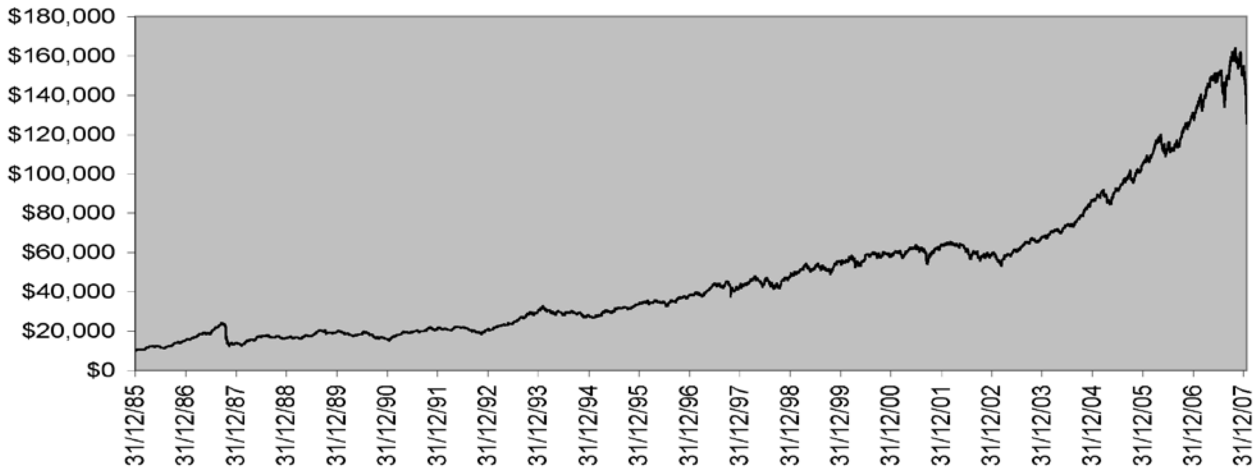
As an investor it may be tempting to move your money out of the Australian share market based on recent events. However, history suggests that when investment markets look bleak, a long term strategy will pay off in the future. This is because markets have always recovered in the past, even after significant losses.

To give you an example, if you invested $10,000 in 1985 and continued your investment despite the stock market crash of 87 and many other events, by the end of 2007 you would have accumulated more than $130,000, as shown by the black line in the graph below.

There's an old saying in the investment community – **until you sell you haven't lost anything.** In other words, you haven't lost any money until you sell your investments at a lower price. You can also lose more than money – you can lose the opportunity to benefit from the subsequent market rebound.

If you are concerned about the recent events and are considering making changes to your investment strategy, it's important that you seek advice from a financial adviser first. They will be able to assess your position objectively and recommend an approach that is suited to your circumstances.

If you don't have a financial adviser, the Commonwealth Bank has a large network of financial advisers that can assist you. Simply visit any Commonwealth Bank branch or call us between 8.30am and 5pm (Sydney time) on 1800 241 996.



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