

Investment smart

A pension is a long-term investment

The current financial crisis has caused much concern due to the way that it has affected the world's leading stock markets. The unusual high levels of volatility that we have been witnessing are partly due to the uncertain times that we find ourselves in, and stock markets hate uncertainty.

It is easy to get caught up in the short-term frenzy of stock market volatility, but at times like these it is important to focus on the bigger picture - your long-term goals. Below we provide some points for you to consider when thinking about long-term investing and your pension.

1. Take some lessons from the past

- Just as seasons come and go, stock markets also go through their own cycles. As we have witnessed recently, they can suddenly plunge only to bounce back the following day. It is said that only two emotions drive markets - greed and fear - both of which can lead to extreme behaviour in stock markets.
- Many of us may remember the stock market crash in 1987, the 'dot com' bubble bursting in 2000 and the after-effects of September 11th 2001. However shocking these events may have seemed, in time the world's markets recovered.

2. Don't make rash decisions

- During periods of extreme volatility, such as those that we have experienced in the current climate, it is only natural to become preoccupied with day-to-day stock market fluctuations and to make rash decisions. It is important to remember that pension investors do not directly invest in stock markets; they invest in funds that invest in the shares of companies.

- For example, if an investor reacts to a market drop by switching out of their funds that invest in shares, they may in effect be 'locking in their losses'. This means that they are not giving their share based funds the opportunity to recoup their losses. Historically patient investors have been rewarded by long-term stock market returns, despite occasional periods of volatility.
- Investors uncomfortable with making their own investment decisions should speak to their financial adviser about developing a suitable balance of investments to match their attitude to risk.
- Anyone without a financial adviser but who would like independent financial advice, can find an IFA in their area at www.unbiased.co.uk.
- Past performance is not a reliable guide to future performance.

Please remember that the value of a pension is not guaranteed. You could get back less than you've paid in.

3. Market Timing

- With stock market uncertainty, investors might think that the best course of action would be to try to anticipate the market's direction and to move their investments accordingly.
- However, it is very difficult to predict stock market movements and to get the exact timing of when to invest just right. This is because stock markets rise and fall in unanticipated spurts, making it easy to 'miss-time' and potentially lose out on the gains.
- Market falls and rises are part of normal stock market life, but by 'drip feeding' a fixed amount on a regular basis it is possible to 'smooth out' stock market movements.
- Contributing a fixed amount on a regular basis may be an effective way of not only saving towards your retirement over time but also 'smoothing out' the fluctuations in the value of a pension.
- Whenever you make a contribution to a fund you buy units in the fund. A unit is essentially a stake in a fund. So, for the same fixed contribution, the lower the unit price for the fund, the more units will be purchased and when the unit price for the fund rises, fewer units will be purchased.
- The beauty of this approach means that the risk of paying for all of the units, perhaps with a lump sum, at the highest price is reduced.

4. The benefits of drip feeding

- When stock markets are very volatile it can be tempting for investors to stop contributing to their pension, but if they do this they may potentially miss out on any upside. This may also mean that investors end up not saving enough to meet their retirement goals.
- In the investment world, regular investing or 'drip feeding' is more commonly referred to as 'Pound Cost Averaging'. The table below, where £100 is invested each month into a fictitious fund, outlines this approach in practice.

Month	Scenario 1			Scenario 2		
	Amount Invested	Fund Unit Price	Units Acquired	Amount Invested	Fund Unit Price	Units Acquired
January	£1,200	£1.00	1,200	£100	£1.00	100
February	0	£1.10	0	£100	£1.10	91
March	0	£0.90	0	£100	£0.90	111
April	0	£0.80	0	£100	£0.80	125
May	0	£0.60	0	£100	£0.60	167
June	0	£0.80	0	£100	£0.80	125
July	0	£1.00	0	£100	£1.00	100
August	0	£0.80	0	£100	£0.80	125
September	0	£0.50	0	£100	£0.50	200
October	0	£0.50	0	£100	£0.50	200
November	0	£0.90	0	£100	£0.90	111
December	0	£1.20	0	£100	£1.20	83
Total	£1,200		1,200	£1,200		1,538

Please be aware that this is only an example, and in practice charges would apply for the management of the fund. These charges would have the effect of reducing potential returns.

Scenario 1

If an investor had invested a lump sum of £1,200 in January they would have acquired 1,200 units in the fund. By the end of the year, using the December price, their units would have had a value of £1,440 (1,200 x £1.20).

Scenario 2

If an investor had invested £100 each month for one year into the above fictitious fund they would have acquired 1,538 units. At the end of the year, using the December price, their units would have had a value of just over £1,845 (1,538 x £1.20).

Summary

The number of units bought will depend on the unit price at the time of purchase. For the same amount, when the unit price is higher less units will be purchased and when it is lower more units will be purchased. Hindsight is a wonderful thing, but in the above example it would have been beneficial to have adopted a policy of regular investing, as more units in the fund were acquired as its unit price fell.

Please remember that when the markets are rising, regular payments may be less effective than lump sum payments.

5. Regular reviews

- Regardless of the current stock market volatility, it is important for investors to review their investments on a regular basis to ensure they are in keeping with their attitude to risk and their retirement goals.
- Investors who are unsure as to how they should go about reviewing their investments should speak to their financial adviser.
- At Friends Provident our Lifestyle Investment Programmes are designed to gradually move an investor's investments into lower risk funds as they get closer to their selected retirement age. For more information please contact your financial adviser.
- Anyone without a financial adviser but who would like independent financial advice can find an IFA in their area at www.unbiased.co.uk.

Key Points

- A pension is a long-term investment and whilst there are no guarantees, history has shown that those willing to invest in shares over the long term have often been rewarded. It is worth noting that shares have outperformed cash and fixed interest investments in seven of the last ten decades (Barclays Equity Gilt Study 2009, Barclays Capital).
- It is easier said than done but investors should consider very carefully any overreaction to stock market volatility. For example, if an investor reacts to a market drop by switching out of their funds that invest in shares, they may in effect be 'locking in their losses'. This means that they are not giving their share based funds the opportunity to recoup their losses.
- Investing a fixed amount on a regular basis is a method that is very effective at smoothing the impact of fluctuations when stock markets are volatile.
- Past performance is not a reliable guide to future performance.

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