How should I invest my money?

April 2017

An investor typically invests their money in a combination of cash, bonds, property and shares. This is known as their investment strategy. The investment strategy should be set to achieve their financial goals (i.e. the expenditure that will be funded from the investments), and to give confidence that the goals will be achieved.

Financial needs

From an investment perspective, we believe that an investor's financial goals include a combination of the three basic needs:

- **Liquidity** to provide for immediate expenditure and allow for unexpected expenditure.
- **Income certainty** to meet the expenditure needs over the medium term.
- **Inflation protection** to cover the need to preserve the purchasing power of the savings, for the longer-term expenditure.

The right mix of cash, bonds, property and shares for an investor (i.e. their investment strategy) should therefore align the pattern of the returns from the investments, with the pattern of future expenditure, reflecting the relative importance of each of the three needs. We call this **the bucket approach**. Generally, cash is good for liquidity, bonds for income certainty (and to a lesser extent the rents and dividends from property/shares), and property/shares for longer term inflation protection. Inflation protection can also be achieved from reinvesting part of the income from the bond and cash investments, though this is generally less efficient from an investment perspective.

The bucket approach

Under **the bucket approach**, the starting point for setting the appropriate investment strategy is to allocate your future expenditure into the different future periods. The future expenditure is then aligned to the types of assets that are the "natural investments" for the relevant period.

The starting strategy should then be modified to reflect the investor's willingness to be exposed to the normal market ups and downs and the possibility of negative returns (i.e. investment risk). Increased certainty (i.e. reduced investment risk) comes with a lower expected return. An investor may also want to modify their investment strategy for their view of the current state of the markets.

The legal stuff

This article is general investment information and is not personalised financial advice. If you wish to receive personalised financial advice, you need to contact an appropriately experienced authorised financial adviser.

Adjusting for risk considerations

An investor may be willing to give up the chance of a higher expected 20-year average return (made up of several positive and several negative years), and accept a lower average return (as long as they get fewer years with negative returns). The question is always, **"is the 20-year average return more important than the returns in each of the individual 20 years?"** If the answer is yes, that might lead an investor to have more property and shares to meet the inflation protection need, than would be held if the answer is no. A no answer, means less volatility is wanted and there is an understanding that some of the potential for longer term inflation protection is given up. It will also mean that the expected future value of the investment will be less.

Remember changes to the starting strategy for risk considerations, should reflect your temperament for ups & downs. For some investors, having more cash (and bonds) and therefore less ups & downs is appropriate. However, it should be remembered that if the markets go down, it is only a problem if you then sell or have to sell, and convert a temporary short term loss into a permanent loss.

Adjusting for the market environment

Remember SuperLife, like all investment managers, does not know what will happen in the investment markets over a specific future period. Managers and "experts", including SuperLife, can only make guesses. Moving from the long-term investment strategy to reflect a view on the current environment and market outlook, is therefore a decision based on a supposition.

Currently, the economy and investment markets are such that: we observe that interest rates are low and the economic growth outlook is low. We think (i.e. we guess) that official inflation is likely to be low, and the general outlook level of uncertainty in the investment markets will be high. We think that the short-term future returns achieved, will be heavily influenced by government policy and central bank actions, and not always commercial decisions. We think this environment may last for several years (beyond 2023).

These factors lead to the following strategy considerations for different investors based on our view for the next 3 years:

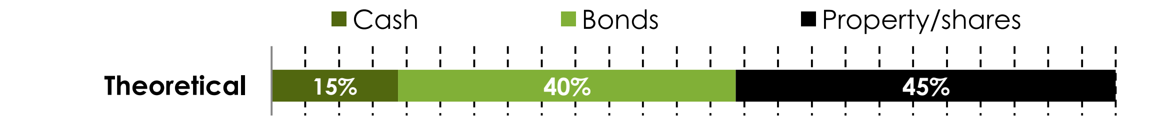
	If the nature of the investor is to be:		
	More "conservative"	**Neutral**	**Less "conservative"**
Income assets (cash & bonds)	Similar overall income assets and at the lower end of the range (but also more cash and less bonds)	Slightly lower overall income assets (and more cash and less bonds)	Lower than normal income assets (also less cash and less bonds)
Growth assets (Shares & property)	Similar overall growth assets	Slightly higher growth assets	Higher than normal growth assets

The above might see the investment strategy adjusted to align with expenditure as follows:

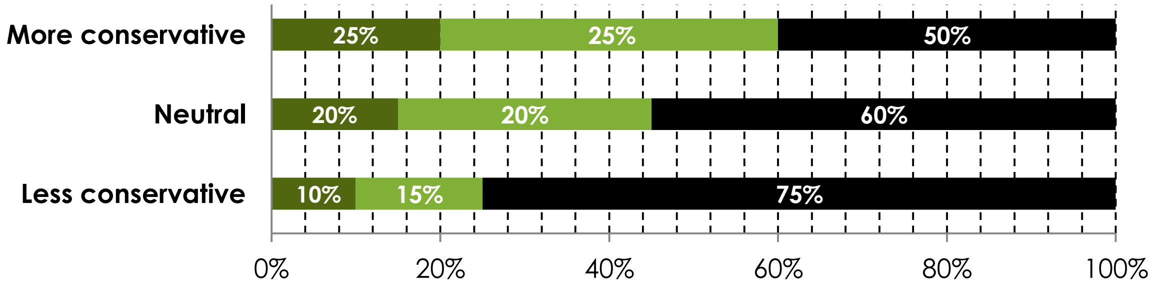
	Cash to cover	Bonds to cover	Property/shares to cover
More "conservative"	5 years' expenditure	6 to 10 years' expenditure	10 years' plus expenditure
Neutral	4 years' expenditure	5 to 8 years' expenditure	8 years' plus expenditure
Less "conservative"	2 years' expenditure	3 to 5 years' expenditure	5 years' plus expenditure

Example

Using, as an example, a person whose retirement plans provide for 20 years' future expenditure (of similar amounts each year in real terms), the theoretical starting-point for the investment strategy would be:



Adjusting this for our current views (guesses) on the market outlook and for different risk profiles, we get:



Note: The article was prepared as at 27 April 2017 and may not be current.