

What to do during volatile times...

World events come and go, with many having short-term impacts on investment markets. These events range from wars (eg the recent Israel conflicts, and the Iraq Wars), natural disasters (eg Hurricane Katrina), boom and bust scenarios (such as the recent Tech bubble, housing prices and resources boom), to even terrorist events (such as September 11 and the London bombings).

However, as far as investment markets are concerned, these world events (as dramatic as they may seem at the time) do not impact the fundamentals.

The fundamental things still apply

The first casualty of investment volatility is common sense. We react to fears and uncertainty by “doing something”, when holding firm can be precisely the smartest and most rewarding move we can make. Investment “booms and busts” come and go through time but sound investing is about fundamentals. Let’s revisit these:

- Investment markets rise and fall and periods of negative returns are inevitable
- Unless your situation or goals change you should think carefully before you change your investment strategy
- The longer you invest the less impact volatility will have on your investment
- Diversification can reduce the impact of volatility on your entire portfolio
- Depressed markets can often represent a buying opportunity

An opportune time

There’s a saying that in the darkest night it’s easiest to see the brightest star. And that’s also true of investing. When shares and equity markets are out of favour, savvy investors see the potential to buy value.

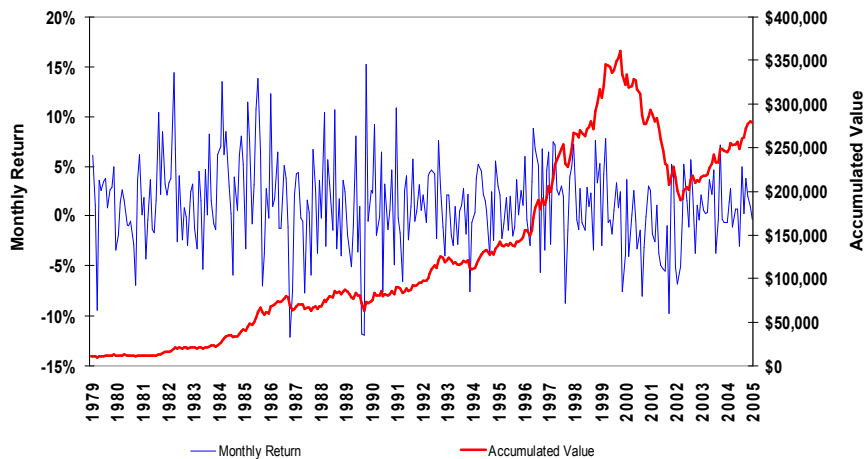
When many inexperienced investors are selling their shares or units, prices are inevitably at a low. By the time everyone thinks the sharemarket will deliver the best returns it’s often too late to re-invest, as prices will have gone back up. So, depending on your circumstances and advice from your financial adviser, times such as these may provide a great opportunity to invest.

In times of market volatility, there is one reality

As one of today’s investors you could easily be forgiven for wondering about what impact the current world events may have on investment markets. However, smart investors know that investment market volatility is not new or extraordinary, but is a natural fact of investing. Resilient investors know that despite the inevitable ups and downs of investment markets, staying disciplined and maintaining a long-term view will give them greater certainty in reaching their ultimate goals. The following chart shows that, while monthly global share market returns can be highly volatile, changing dramatically from month to month, the long-term trend is up – the long-term investor will make good returns on their investment if they stick to their strategy.

Short term noise, long term clarity

Global share returns



Source: MSCI World Gross Accumulation Index (\$A)

2

Smart investors focus on the long-term average and accept the monthly, yearly or even several year return, as short-term volatility. While sharemarkets generally reflect the broader economic environment, you must expect some years of low or negative returns during the time you are invested. But the reality is that in the past, most markets have bounced back and eventually returned to and surpassed previous levels.

As a result, events like October 1987 sharemarket crash, Gulf War in Jan / Feb 1991, Tech Wreck in April – October 2000, September 11 (World Trade Centre attack), subsequent war with Iraq (March 2003) are often only a little bump in the road of financial history.

A tale of two journeys

In times of negative returns, there is a natural temptation to chase the perceived higher returns from other investment options. Studies show that investors who switch funds to the best performing asset class of the previous year, chasing higher returns, are often worse off than investors who maintain their investment in a balanced portfolio.

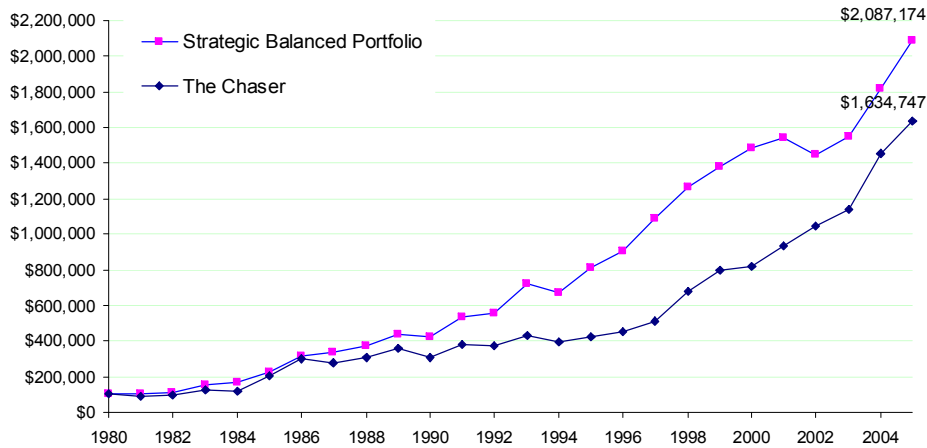
For example, if you invested \$100,000 over the last 25 years:

- If you chased the best return in a single asset class from the previous year, your investment at the end of 2005 would be valued at \$1,634,747.
- But if you stayed invested in a generic balanced portfolio, your investment would have been worth \$2,087,174.

Simply by chasing returns, you would have generated a lower return on your original investment of over \$400,000. We often create more volatility in investments by simply switching course and trying to cash the best performing asset class.

The Chaser vs a strategic balanced portfolio

Value of \$100,000 Since December 1980



Data: Australian Shares based on the S&P / ASX All Ordinaries Accumulation Index, Global Shares based on the MSCI World Gross Accumulation Index (\$A), Australian Bonds based on the Commonwealth Bank Bond Accumulation Index, Listed Property Securities based on the S&P/ASX200 Property Accumulation Index (Listed Property Trust Accumulation Index prior to July 2000), and Cash based on UBS Warburg Australia Bank Bill Index (RBA 13 Week Treasury Notes prior to April 1987).

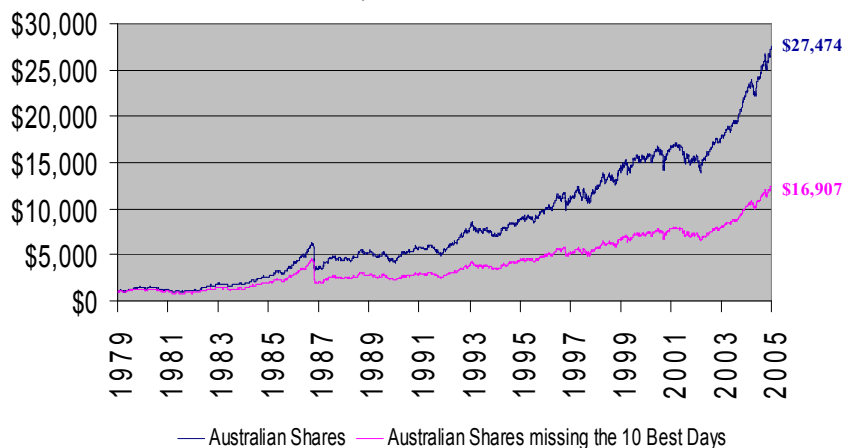
The Strategic Balanced Portfolio is based on the average asset allocation of Balanced Funds within the Mercers Wholesale Performance Analytics toolkit as at 31 December 2005 (Australian Shares 37%, Global Shares 24%, Australian Bonds 31%, Listed Property Securities 8% and Cash 0%).

Time in the Market

Many investors try to reduce their investment volatility by selling when markets are falling and buying when they pick up. This not only doesn't make sense, but these investors often miss out on many of the good days of high-performing returns. Missing just a few good days may cost you a large amount of money – for example, if you missed the best 10 days in the Australian share market from 1 January 1980 to the end of 2005, your efforts at market timing would have cost you over \$10,000 on an original investment of just \$1,000 [see below graph].

Missing the 10 Best Days

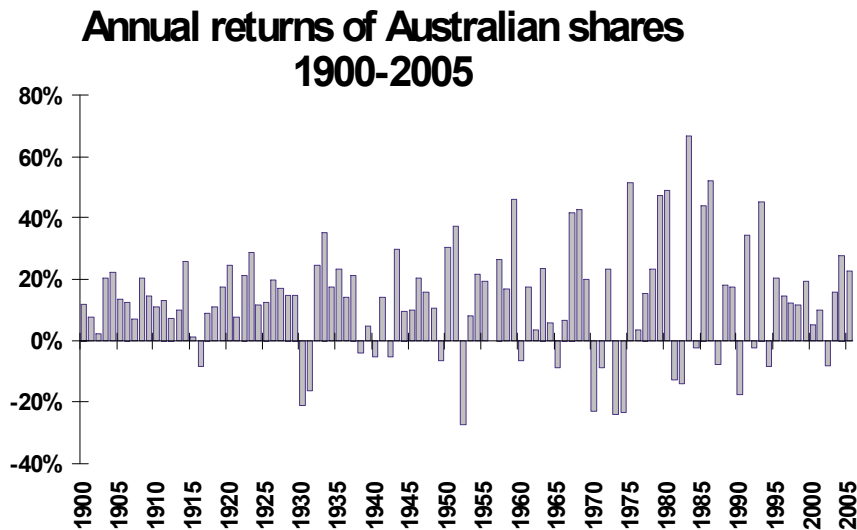
value of \$1000 invested in 1979



The returns outlined above represent historical performance only.
 Data: All Ordinaries Accumulation Index December 1979 - December 2003.
 S&P/ASX 300 Accumulation Index December 2003 - December 2004.

History proves there are more positive periods in the market than negative. For example, the following graph shows the annual returns of the Australian share market over the last 100 years – you

can see that not only are there a lot more bars above the line than below it, but the positive bars are also generally a lot higher than the negative bars.



The returns outlined above represent historical performance only.
Calculated using data from DMS Data Module offered through the Ibbotson Associates' software
program EnCorr. 2004 return - S&P/ASX 300 Accumulation Index

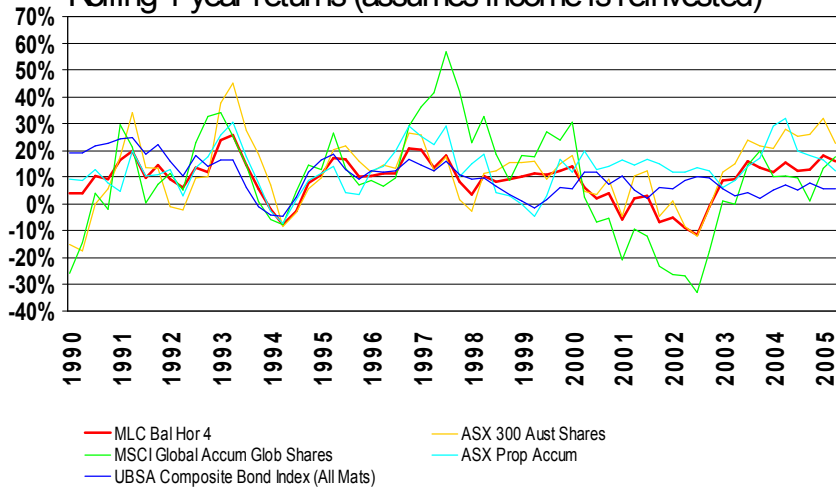
Further, the longer you're out of the market the worse off you may be. If you are out of the market over a long period of time, you may miss out on substantial opportunities to grow the value of your portfolio. During these volatile times, it is important to stick to your long-term goals.

The longer you invest, the less impact volatility will have on your investment. Instead of trying to time the market, a much easier way to reduce the effects of volatility on your portfolio is to diversify your investment across all asset classes.

Diversified portfolios are designed to lessen the effects of volatility on your portfolio while still providing the benefits of the potential higher returns provided by some asset classes. For example, the red line in the following graph shows the much smoother ride you would have had in MLC Horizon 4 – Balanced Portfolio (which is well diversified across many asset classes) when compared with several major individual asset classes.

Diversification reduces volatility

Rolling 1 year returns (assumes income is reinvested)



Australian Shares: All Ordinaries Accumulation Index, Global Shares: MSCI World Gross Accumulation Index (\$A), Australian Bonds: Commonwealth Bank Bond Accumulation Index, Listed Property Securities: S&P/ASX200 Property Accumulation Index (Listed Property Trust Accumulation Index prior to July 2000), MLC MasterKey Unit Trust Horizon 4 Balanced Portfolio.

4

Talk to someone who understands your financial position and goals.

If you're in any doubt about your investment strategy, or you see an opportunity to take advantage of the current market conditions, the best person to seek advice from is your financial adviser. Your planner knows your individual circumstances and is in the best position to give you personalised advice. Together, you can reassess or reinforce your financial goals.

Above all, keep in mind the fundamentals of investing and you stand to become a successful investor.

If you don't have a financial adviser, we can put you in touch with one. Please refer to your statement for contact details.

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