A Resolution Worth Keeping

When the calendar turns over to a new year, we often find ourselves making pledges to ourselves — whether it's getting into shape, spending more time with our families or quitting all those things that aren't good for us.

Aware of this seasonal desire for renewal and reinvention, particularly after a year of such momentous volatility, a large part of the investment industry is busy marketing financial New Year resolutions.

For distraught investors looking for a fresh start, these slickly advertised promises to "armour-guard" portfolios, quarantine retirement savings and make money in down markets can seem awfully tempting. But it's at these times that we need to remind ourselves that our search for investment quick fixes can leave us vulnerable to the persuasions of those who make promises they know they have no chance of keeping.

Just look at the performance of hedge funds in the past year for example. These highly speculative and complex investment vehicles promised to deliver positive returns in any market and charged very fat fees for doing so. But many hedge funds are struggling to keep their promises and indeed stay in business.

According to Hedge Fund Research[1], hedge fund encashments were up by 70 per cent in the third quarter of 2008, with a record 344 funds closing. And this was *before* the impact of the scandal involving alleged Ponzi scheme operator Bernard Madoff, to whom some funds of hedge funds had a large exposure.[2]

As one analyst observed, the global financial crisis may merely have confirmed what many suspected; that the "outperformance" that many hedge funds were charging all that money for was just the ordinary market return.

We have never used hedge funds because of the lack of transparency.

So what's the answer as you review your returns of 2008?

Firstly, be wary of any marketer of an investment solution that promises to "beat" the market or puts your money at the mercy of their own forecasts. There are very few Warren Buffett or Anthony Bolton's out there, both of whom by the way are buying into the stockmarket.

Secondly, ask yourself whether you understand what you are investing in. It is difficult to judge your risk exposure and level of diversification when your fund refuses to disclose its activities beyond the most basic requirements.

Thirdly, even if the fund managers really are highly skilled, consider who really reaps the rewards from their activities. Is it you as the end investor or the managers themselves?

Lastly, before you make any rash decisions, you might consider an alternative approach — one that makes no promises other than ensuring your portfolio gains reliable and efficient exposure to asset classes worldwide.

This approach recognises that markets are inherently unpredictable and that risk and return are related. Your best chance of harvesting the gains on offer is to remain disciplined in a diversified portfolio built around the known dimensions of risk.

To be sure, the returns to be gained from taking on that risk are not always there, which is why they are called *risk* factors. But you are more likely to have a successful investment experience with this approach than you are by placing faith in those that promise you the world. Had you invested into UK Treasury Bills, one of the safest forms of investment, and remained invested from 1987 to 2007 your £10,000 would have risen to £40,883.18 whilst £10,000 into the FTSE All-Share Index would have risen to £76,313.[3]

It's a New Year's resolution worth keeping.

[1] 'Hedge Funds Face Bleak Future', *the Sunday Telegraph*, Dec 21, 2008
[2] 'Broad Probe into Hedge Fund', *the Wall Street Journal*, Dec 26, 2008
[3] DFA Matrix Book 2008

Past performance should not be used as a guide to the future

Do not act on this information alone!

If you would like to discuss this in more detail, please contact:

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