

Dear Reader,

## Market Sentiment

I'm often asked where I think we are in the 'Economic cycle'. My personal view, and it is just that and shouldn't be relied on as a reliable indicator of whether to buy or sell investments, is that we are almost at the complete opposite position we were a little over two years ago.

Cast your mind back to May 2007, a time when the media was yelling at us to buy now to capitalise on rising share prices. A time when market sentiment was blindly optimistic. A time when the end to a healthy bull market was just around the corner. And a time when money was 'cheap and easy'.

After glancing back over the forecasts I collected for 2007, I can't see a single media headline that is negative on the economy, its outlook or the direction for stocks.

If market sentiment was extremely positive two years ago, and we know what soon followed that blind optimism, is it reasonable to apply that same logic on the opposite end of the emotional spectrum today? **Article continued on page 2**

Our office will close on Friday 18th December and reopen on Monday 4th January. We will check email and phone messages intermittantly during this time.

Hope your Christmas is happy, fun and safe

**Darren, Lindsey and Belinda**

## When the Luck Runs Out

In the 2009 Rugby League grand final, the star player in one team sent a police escort to his home to fetch a missing "lucky" red boot. The shoe arrived in the dressing room just in time for kick-off. His team ended up losing anyway. So should he blame the shoes?

Just like sports stars who attribute their

success to lucky charms or pre-game rituals, many investors follow their own superstitions in the market — like never trading in January or avoiding stocks that start with the letter 'L' (for 'loser').

When these investors do well, they attribute their successes to their own skills and decision-making. Conversely, when their investments suffer, they tend to blame unknown or external factors beyond their control. Yet it is likely that these various outcomes are just random.

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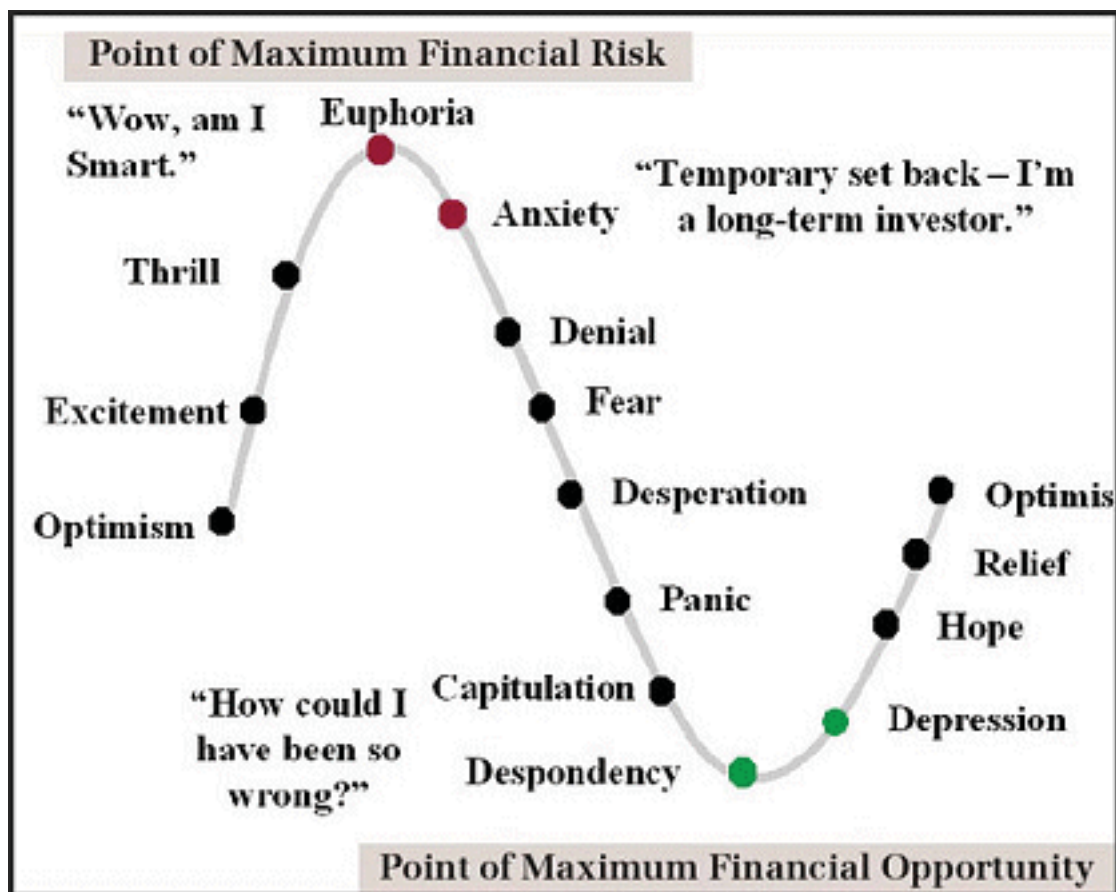
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**'Market Sentiment' continued from page 1**

An article on market sentiment needs a graphic to illustrate the different phases.

In hindsight, the start of the credit crisis in August 2007 looks to be Anxiety; and the resumption of optimism to see the All Ordinaries hit a record high in October 2007 as Denial. Moving forward to September 2008, I think it is fair to say Fear dominated market sentiment. I believe Desperation and Panic followed in October and November 2008. The lows in March 2009 were followed by a series of short, sharp surges that sent waves of hope through investors the world over.

So where do I think we are in the market sentiment cycle now? Personally I believe we are somewhere between Hope and Relief, which is why I also believe there are more good times ahead for disciplined investors.

Having said this, I am not suggesting you rush out and take a margin loan against your line of credit and buy a geared global

resource. To do so would be missing the point, that I am not making a (destined to fail) attempt to guess when the share market will 'bottom out', but rather that investor sentiment follows a trend over the course of an economic cycle. Sentiment can fluctuate and it could remain at Despondency and Depression for a long-period of time (read several years) before Hope gives way Optimism.

*"It's important to choose not who you think is the prettiest girl, but who the judges will think is the prettiest girl."*

*John Maynard Keynes*

The "judges" are the herd of investors and it is not prudent to wager against them. That is, the Crowd (investor herd) "is "right" most of the time... but not all of the time. The few points at which the crowd is "wrong" are marked by extreme emotion, which I would more specifically define as "blind optimism" or "blind pessimism."

The media also perpetuates this blindness by choosing the sensational headlines, rather than those of rational perspective. For example a headline that appeared earlier this year cried out "Most Jobs Lost in 34 Years". This headline is accurate only by the number of job losses, but when measured by percentage; it ranks at a modest 41st in historical rank. Not much of a headline at all really.

The four most dangerous words for an investor are "it's different this time." I concede that the global economy has weakness with several pockets unlikely to experience any growth for, in some cases, years or longer; however, my logical conclusion with respect to market sentiment is that things are not as bad as most perceive them to be and perhaps a bit worse than a very small minority perceive them to be.

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As an investor and an investment adviser, I won't bet that we are headed for another Great Depression just as I won't bet that we are entirely out of the woods. What I do believe is that successful investors should not be afraid to keep to their plan, regardless of the noise, even if they appear to look 'foolish' at the time.

*"What the caterpillar calls the end of the world, the master calls a butterfly."*  
Richard Bach

Finally, when I sit alone in a quiet place to explore my inner thoughts and feelings, I will admit that I am a person who simply chooses to maintain faith in capital

markets even when I am (apparently) surrounded by the darkest of clouds. However, I also work hard at being a logical and curious thinker, which has served me well as an investor and a money manager. As such, I am aware of where the crowd is, but I find little use in blindly following them.

# A Tale of Two Summers

An apology to Dickens, as it has been the worst of times and the best of times for investors. In fact, the unpredictable nature of markets has rarely been more evident than in the past two years.

Neither has volatility ever been so pronounced; large daily swings, particularly during the worst of the crisis last year, became almost commonplace at one stage.

An understandable reaction among many investors to the volatility was to cry: "Stop the ride, I want to get off!" The problem, as always, was that many people capitulated just before the turn in sentiment earlier this year (I take some comfort knowing not one of our clients abandoned their investment plan, and are now well on their way to recovering any losses sustained).

To highlight the extremes of 2008 and 2009, we have compiled a table (see below) of the top three monthly gains and the top three monthly losses for a range of asset classes we invest in.

What's remarkable is how so many of the top monthly gains have been posted in 2009 and how many of the worst losses were registered in 2008. This is the case even for our most well-established strategies, with track records of around a decade.

Take Australian Small Companies as an example. The investment we use was established nearly a decade ago, yet its three top monthly percentage gains have all been posted in the last six months. Likewise, its three worst months were all wracked up during the horrors of 2008.

In many cases, the worst months came within weeks of the best months. Global Value shares, for instance, suffered a fall of 13.7% in February this year, its worst month in a decade. Two months later, in April, was the best ever month with a gain of 12.6%.

For those who still claim some ability to time markets, this makes for sobering reading. Even those who managed to get out before the carnage of 2008 still had to know how to finesse their re-entry in such a way as to enjoy the best of these concentrated gains. That is a very, very big ask.

For sure, some analysts were saying back in February that the markets were oversold. But not many of them, if any, were on record as saying that major world indices would rebound by between 40 and 50 per cent within months.

Now, it is never advisable to get overly focused on short-term returns, particularly from month-to-month or even quarter-to-quarter.

But this illustration does provide an emphatic reminder that markets are unpredictable. Sometimes, as many discovered, they can be very scary.

But over time, markets deliver a positive return. And the only known reliable way of securing that return is by exercising patience and discipline and staying invested.

	Top 3 Monthly Gains		Top 3 Monthly Losses	
Aust Small	1. March 09	13.7%	1. Oct 08	-23.4%
	2. April 09	12.9%	2. Jan 08	-12.7%
	3. July 09	10.2%	3. Sept 08	-12.2%
Aust Value	1. March 09	13.9%	1. Oct 08	-13.3%
	2. July 09	11.2%	2. Feb 09	-11.2%
	3. Oct 01	8.3%	3. Jan 08	-9.4%
Aust Large	1. March 09	7.9%	1. Oct 08	-11.5%
	2. July 09	7.3%	2. Jan 08	-10.5%
	3. Aug 09	6.7%	3. Sept 08	-9.3%
Global Value	1. April 09	12.7%	1. Feb 09	-13.7%
	2. July 09	8.0%	2. June 08	-11.0%
	3. Aug 08	7.6%	3. Sept 02	-10.4%

Note: Returns are net of fees and in Australian dollars. Period 1 September 1999 to 31 August 2009. Source of data: Dimensional Returns program.  
Aust Small = Dimensional Australian Small Co Trust  
Aust Value = Dimensional Australian Value Trust  
Aust Large = Dimensional Australian Large Co Trust  
Global Value = Dimensional Global Value Trust

### 'When Luck Runds Out' continued from page 3

Economists describe this tendency to claim all the credit for good things and disown the bad as "self-attribution bias". It's just one of a number of typical behavioural biases affecting investors.

Common behavioural biases also include overconfidence (a tendency to believe we are better investors than everyone else) and hindsight bias (a tendency to see peaks and troughs as obvious, after the fact).

Other prevalent biases identified by researchers include familiarity (a tendency to invest in only what we know, thus giving ourselves a false sense of control), regret (a tendency to become overly conservative after a bad investment experience) and extrapolation (a tendency to assume the market will continue in its recent pattern).

In dealing with hundreds of clients during good times and bad, many of these biases, while helpful in some areas of life, can be destructive if we act upon them as investors. Overconfidence, for instance, can be a useful attribute for an entrepreneur. But investors who let

their egos direct their decisions can do themselves immense harm.

The assumption behind the ego-centric approach is that investing is akin to speculation. Like poker machine addicts adamant that one machine pays out more than another, speculators want to believe that they can control alot more than they actually can and see themselves as doing battle with the market.

The practical outcome of allowing these behavioural biases to dictate decisions is that one often fails to reap the benefit of good markets or, in down markets, they make a bad situation worse: By buying high and selling low they accumulate large tax liabilities and end up with concentrated portfolios with exposure to unnecessary stock and sector-specific risk.

It doesn't have to be this way. While our behavioural biases will always be with us and often are useful in our everyday lives, we can help ourselves by limiting their influence on our investment decisions and, instead, by paying attention to those things within our control — like diversification and discipline.

The fact is the stock market will always move up and down. Such is its' nature. There will always be uncertainty. But we can comfort ourselves with the fact that the share market is extremely efficient in pricing in news, certainly more efficient than even the smartest individual without inside information. And unlike the casino, the odds are with investors who don't succumb to behavioural biases.

So ironically, it is by letting go of our ego-driven impulses toward the market that we become able to reap the returns from disciplined long-term investment and minimise the damage that our behaviour can wreak on our portfolios.

If you think of investing as speculating, you're equating it with gambling. Yet we all know the odds favour the house, not the gambler. With investing, you accept the ups and downs, knowing that the odds favour the investor. All you need is a little time.

So investing is not like a football grand final where there is one winner and one loser. All participants can be winners. And you don't need a pair of lucky red shoes.

## Do you know the difference between http and https?

I don't know how many are aware of this difference, but when I stumbled across this last week I deemed it worthy of sharing with as many people as possible.

When you are on a web page, the first letters in your address bar are almost always http. HTTP stands for Hyper Text Transfer Protocol, which is just a fancy way of saying it's a computer language. This is the language used for information to be passed back and forth between web servers and you, the internet user.

The important thing is the letter S which makes the difference between HTTP and HTTPS. The S stands for "Secure". If you visit a website or webpage, and look at the address in the web browser, it will likely begin with the following: <http://>.

This means that the website is talking to your browser using the regular 'unsecure' language. In other words, it is possible for someone to "eavesdrop" on your computer's conversation with the website. If you fill out a form on the website or provide personal information, someone might see the information you send to that site.

This is why you should never ever enter your credit card number in an <http://> website! But if the web address begins with <https://>, that basically means your computer is talking to the website in a secure code that (virtually) no one can eavesdrop on.

If a website ever asks you to enter personal or credit card information, you should automatically look to see if the web address begins with https:// or <https://> .

If it doesn't have an 's' be very careful about entering sensitive information like a credit card number when an unknown 3rd party can potentially listen in.

Spread the word.

**Disclaimer:** This publication has been prepared for general information purposes only. It is not specific advice to any particular person. You should consult your licensed financial adviser before making investment decisions.

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