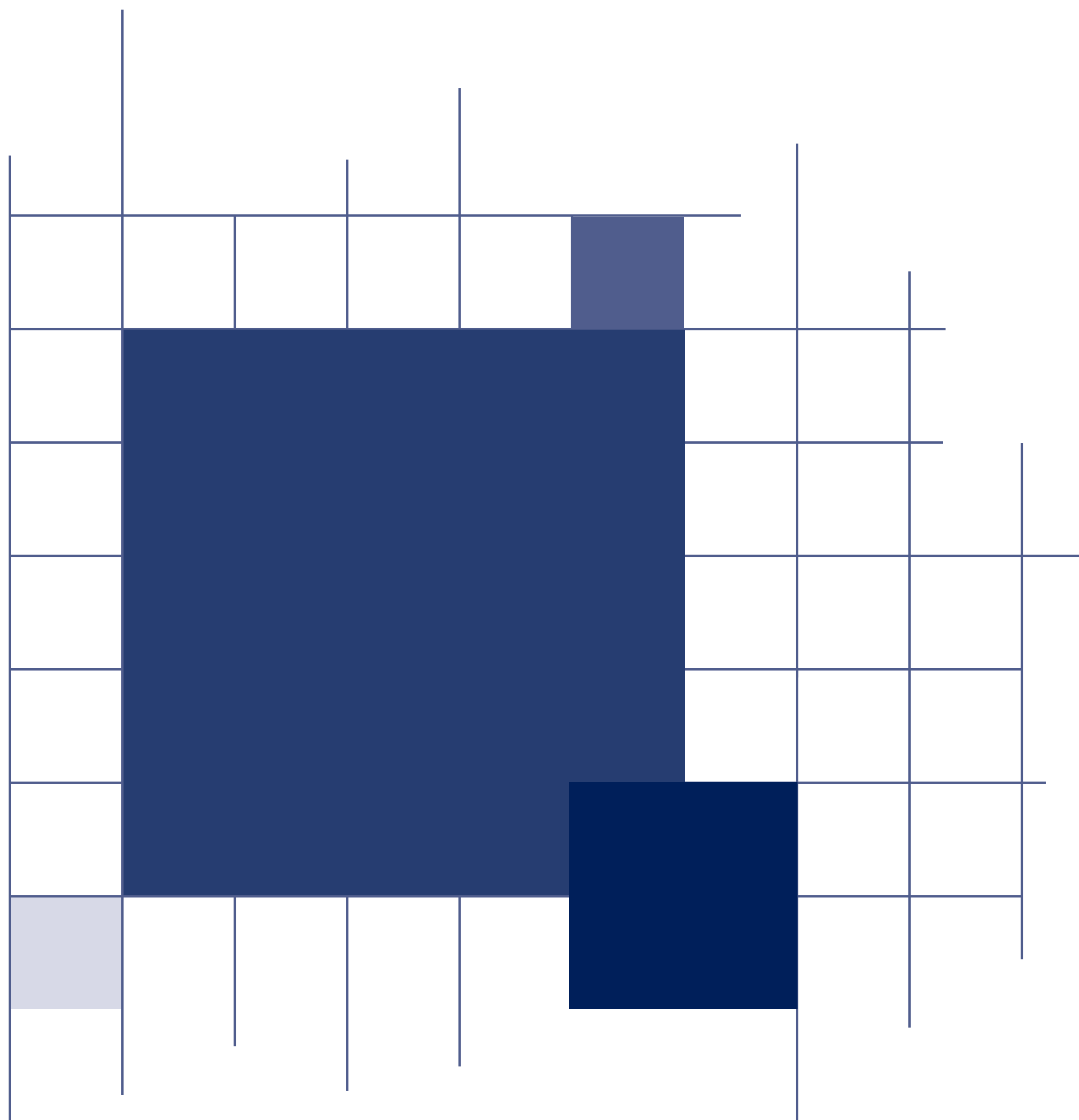


Why Stock Market Investment?

The leader in MultiManager investment

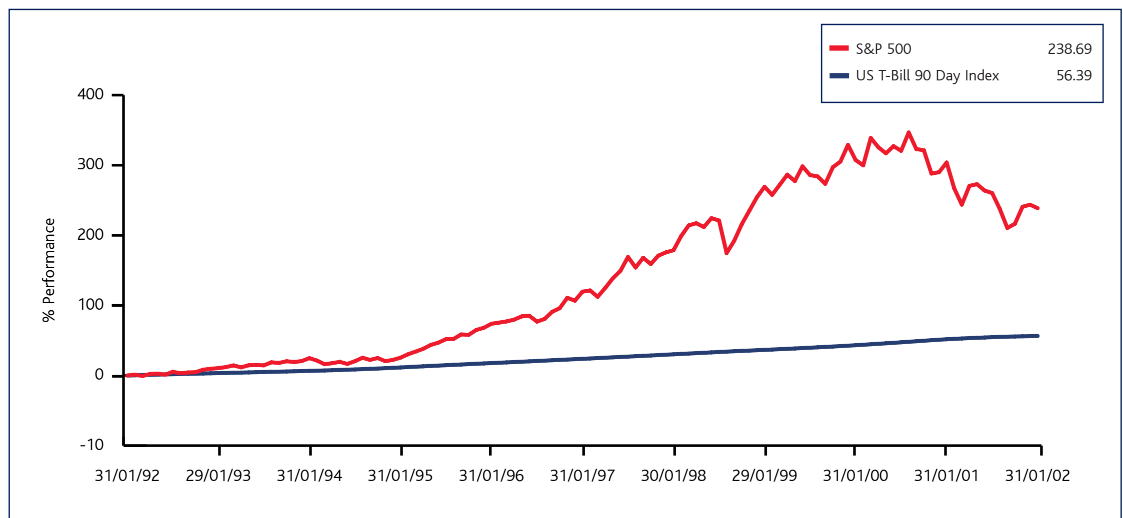
Royal Skandia

Why equity investment

is better than cash

Many people are deterred from stock market investment due to the fear that a fall in the stock market might jeopardise their financial security. But, there is an element of risk in all investment.

Holding cash in a deposit account is considered very safe, but historically it has not always provided even a basic hedge against inflation, and cannot generally be regarded as the most effective form of long-term investment. Clearly stock market investment can provide excellent long-term returns, illustrated by the chart below.



Source: Standard & Poor's Micropal, gross income reinvested, bid to bid, US Dollar 10 years to 31 January 2002. Unlike capital invested in US Treasury Bills, the capital invested in equities or unit-linked funds is not secure and the value of units may fall as well as rise. Past performance is not necessarily a guide to the future.

The key to successful stock market investment lies in standing back from day-to-day uncertainties and appreciating the long-term nature of the returns available. Of course, there have been periods of underperformance and even well publicised market falls. However, the overall trend of the world's major stock markets has been upwards over the past 10 years.

Stronger long-term returns are the reward for this exposure to short-term uncertainty and volatility. However, in general terms, short-term volatility will not be a concern to the long-term investor and will only have an adverse impact if an investor is forced to encash at the wrong time. The risks of this eventuality can be minimised by regular monitoring over the lifetime of the investment and the movement towards less volatile investments as the target date for the planned encashment of the investment approaches.

Of course, the amount committed to stock market investment will depend on your circumstances, and any decisions should be taken in conjunction with a professional adviser.

Staying invested in difficult markets

While investment markets remain uncertain and volatile, investors begin asking questions.

- Am I going to lose my money?
- Should I cash in my investments and put my money in the bank?
- Is now the time to switch funds?

These are impossible questions to answer - and only time will tell if you have made the correct decision. However, we can draw on past experience by looking at times when the markets have been equally nerve-racking.

What has happened?

When markets recover, they tend to bounce back fairly robustly. Research conducted by Fidelity shows that:

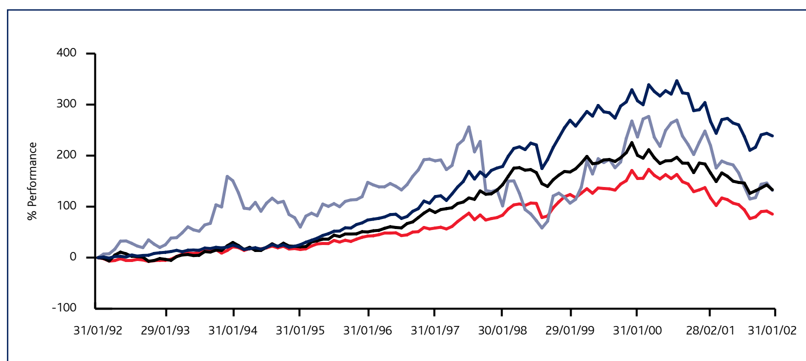
- on average, markets rise by 9.8% one month after they reach the bottom of the trough in a bear market (26.2% over 12 mths).
- equity market returns tend to be concentrated into a relatively small number of trading days, some of which happen immediately after sharp declines.
- it's at this point that many investors are nervous about investing, and as a result miss some of the strongest rises.

What else can reassure a nervous investor?

The past ten years have seen some catastrophic incidents:

1991	Bay of Bengal cyclone kills 135,000 in Bangladesh	Desert Storm launched - Iraqi troops destroy 1000+ oil wells in Kuwait
1992 - 1995	Conflict in/around Yugoslavia - includes genocide, and UN/NATO intervention	
1994 - 1997	Conflict in Rwanda - includes mass genocide, 225,000 flee refugee camps	
1995	Assassination of Prime Minister Rabin in Israel	
1996	Oklahoma bombing	
1997	9,000+ die in US Hurricane Mitch	First nuclear tests from India/Pakistan
1998	15,000+ dead in Turkish earthquake	
2000-2001	Mad Cow disease spreads across Europe	11 September 2001 Terrorists target the US

The following chart shows how major world stock markets have performed during these torrid times.



S&P 500	238.69
Hong Kong Hang Sang	131.79
FTSE All Share	133.19
MSCI World Index	85.42

Returns that clearly demonstrate staying fully invested no matter what is going on in the world is a sensible investment strategy.

Source: Standard & Poor's Micropal, bid to bid, US Dollar, gross income reinvested to 31 January 2002. Past performance is not necessarily a guide to the future.

Royal Skandia allows clients to phase their new lump sum investments over 3, 6 and 12 months. This means you do not need to be timing experts to benefit from stock market investment. Phasing your lump sum to take advantage of pound cost averaging, that is spreading the risk of investing on one particular date, can be just as effective.

The case for long-term
equity investment

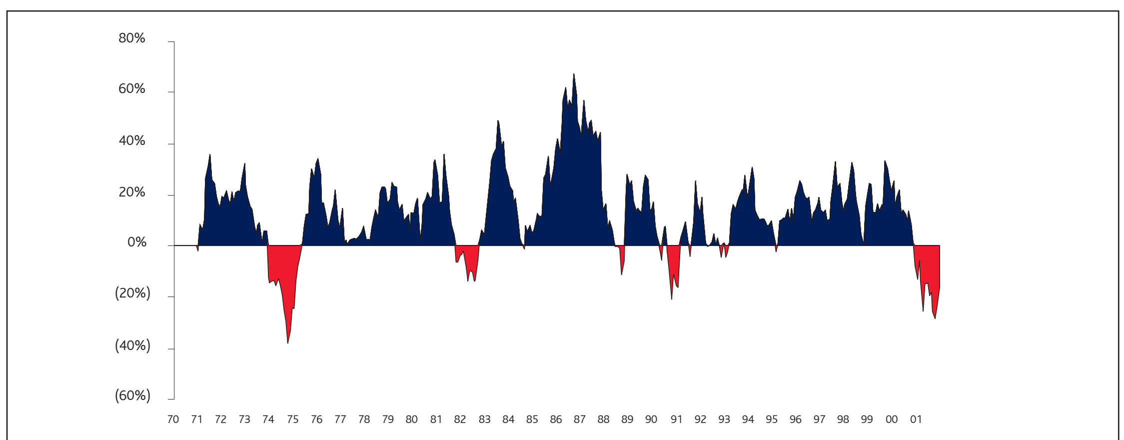
Two internationally respected fund management groups, Franklin Templeton Investments and Fidelity Investments, provide summaries of their in-depth analysis into the characteristics of world equity markets.

Should we be afraid of the bear?

According to Franklin Templeton, the simple answer is that no one knows for sure. However, if you look back over many years, it is apparent that these questions are not as critical as they might appear. Although we are in a bear market, history suggests that it is likely to be of a short duration, and may provide opportunities.

The graph below tracks the MSCI World Index from 1970 onwards, and its message is clear - the number of bull markets exceeds the number of bear markets. In addition, the bull markets tend to be longer - and the gains of the bull markets outweigh the setbacks that the bear markets produce.

MSCI World Index Performance*



Source: Datastream, Franklin Templeton Investments.

*Trailing 12 month compounded return, to end December 2001 - this means the graph calculates percentage growth over 12 monthly periods. So, for example, the first 12 month rolling period is from start of January 1970 to end of December 1970, the second 12 month rolling period is from start of February 1970 to end of January 1971. Investors should be aware that the value of units may fall as well as rise. Past performance is not necessarily a guide to the future.

All equity markets carry risk, but they reward the investor who is patient. History indicates that the rewards of being 'in the market' outweigh the risks.

Both bull and bear markets will always occur. The long-term investor should not fear a bear market as they often provide the greatest opportunity. The feelings of pessimism which bear markets produce have a beneficial effect as they create the opportunities for picking up bargains - a key element of the value style of investment.

In times of growth, the attractions of stock market investment are very clear. But, in times of falling markets, many potential investors will be concerned about the effects of short-term fluctuations on their lump sum investment.

Looking at the stock market over the longer term enables investors to put the current turmoil into perspective. And the research conducted by Franklin Templeton shows that the good times outweigh the bad.

Market Timing

During times of stock market volatility it is only natural to be concerned about the effects of market fluctuations on your portfolio, and it is tempting to revert to cash holdings. Many experts agree that investors will be usually be better off resisting the temptation to make changes to their long term investments simply because of short term stock market movements.

Missing the Gains

Just as the sharp falls in stock markets tend to be concentrated in short periods of time, the best gains are similarly concentrated. Because these gains often occur just before, or after a market fall - an investor who tries to time investments is highly likely to miss the best gains.

Market	Index	Stayed fully invested	Missed best 10 days	Missed best 20 days	Missed best 30 days	Missed best 40 days
UK	FTSE All Share	+14.4% pa	+11.3% pa	+9.1% pa	+7.3% pa	+5.6% pa
US	S&P 500	+16.7% pa	+13.1% pa	+10.4% pa	+8.1% pa	+6.0% pa
Germany	DAX 30	+15.4% pa	+10.3% pa	+6.9% pa	+4.1% pa	+1.6% pa
France	CAC 40	+17.9% pa	+13.5% pa	+10.3% pa	+7.6% pa	+5.2% pa
Hong Kong	Hang Seng	+19.7% pa	+11.5% pa	+6.6% pa	+2.5% pa	-1.0% pa

Source: Fidelity Investments, annualised returns. Indices in local currency, net income reinvested from 31 December 1987 to 31 December 2000. Past performance is not necessarily a guide to the future.

Fidelity's analysis of stock market returns, conducted over the period 1988 to 2000, shows that missing just a few days' stock market performance can significantly impact overall performance. Missing the best 40 days (equivalent to about four days a year) has reduced annualised returns from the US and UK stock markets by around 60%, with even greater lost returns in other markets.

Is it worth the risk?

Further analysis by Fidelity shows that even successfully identifying the market low and investing on that day does not provide a significant additional return. Fidelity took three hypothetical investment strategies:

- investing each year at the market low - the best strategy
- investing each year at the market high - the worst strategy
- investing at a random date (1 January) - a typical investors strategy.

Market	Worst Strategy (High Point)	1 January	Best Strategy (Low Point)
UK	+15.2% pa	+16.5% pa	+17.2% pa
US	+13.9% pa	+14.6% pa	+14.9% pa
Germany	+11.9% pa	+12.6% pa	+12.8% pa
France	+15.7% pa	+16.7% pa	+17.3% pa
Hong Kong	+16.6% pa	+18.7% pa	+19.4% pa

Source: Fidelity Investments, annualised in local currency returns, net income reinvested. Annual investment 31 December 1970 to 31 December 2000 calculated using MSCI country indices. Past performance is not necessarily a guide to the future.

Not surprisingly, investing at the market low produces a better return than investing at the market high - but in each case, the difference in returns between the high and low point for each market is small. Investing at the random date produces returns between these two extremes and the difference between investing at a random date and the market low is only around 0.5% on an annualised basis.

Investors can take reassurance that they do not need to be timing experts to benefit from stock market investment. Even the unlucky investor who every year for 30 years invests on the worst possible day has enjoyed a very healthy return from stock market investments.

Remember time, not timing, is the key to investing.

The benefits of regular contributions

in a volatile market

It is impossible to know exactly when stock markets have 'bottomed out' and are set to rise again. However, staying out of the markets can prove just as costly as not picking the very best time to invest.

All Royal Skandia products (excluding single premium bonds) enable you to make regular monthly or annual contributions. Saving in this manner can have certain advantages over investing one lump sum. In fact it can prove beneficial during times of increased volatility - as shown below.

Ups and Downs can mean more profit

US$1,000 per year investment	Volatile Fund A		Stable Fund B	
Year	Unit Price (cents)	No. of Units bought	Unit Price (cents)	No. of Units bought
1	100	1,000.0	100	1,000.0
2	160	625.0	115	869.6
3	110	909.1	130	769.2
4	60	1,666.6	120	833.3
5	90	1,111.1	130	769.2
6	140	714.3	140	714.3
Total Units	-	**6,026.1**	-	**4,955.6**
Total Value	(@140)	**US$8,436.5**	(@140)	**US$6,937.84**

A regular contribution or a phased investment buys a varying number of units as unit prices fluctuate with normal stock market movements. When prices are low, the regular contribution or phased investment buys more units, and when prices rise it buys fewer.

By buying a stock market or equity based investment through a regular contribution, especially in a period of downward stock market volatility:

- You can spread the risk of investing on one particular date when prices may be abnormally high, and take advantage of pound cost averaging.
- It instills the discipline of investing on a particular date each month, which could mean investing at a time that would normally make you nervous - but could provide the best long term returns.

Phased investment is available with the Royal Skandia Managed Capital Account and Executive Wealthbuilder Account. It allow clients to drip feed new investments over 3, 6 or 12 months.

This piece of literature is available on the Royal Skandia web site.

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