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MEDIA RELEASE

New research debunks investment myth
Share market investments not predictable over the long term

16 November 2015 - Long term equity risk premiums* (ERP) in Australia are far more unpredictable than currently thought according to new research from Drew, Walk & Co.

The research report, released today, shows that the ERP is volatile, and its timing and magnitude, unpredictable.

Jeremy Cooper, Chairman, Retirement Income at Challenger, which commissioned the research, said: "The results were indeed surprising. We all know equity investing involves swings and roundabouts, but conventional wisdom suggests it's expected to smooth out over the long term. But this actually isn't the case.

In fact, the historical average equity return (out)performance over 20-year periods in Australia since 1900 has ranged between 12% and minus 1.5% a year, above the return on government bonds.

"Equity investing in retirement is like spinning a chocolate wheel, there are plenty of winners, but also losers. Even a 20-year period does not ensure that taking equity risk will be adequately rewarded and this is important for retirees to understand," said Mr Cooper.

Since 1995, investors have only been rewarded with an additional 1% return a year for taking on extra risk in equity markets.

"Of course, equity risk is of particular relevance in the context of retirement with superannuation investments relying on equity markets for long-term growth."

Research from the Morningstar DMS database shows the volatility of equity returns. If you were invested in the Australian share market from 1960-1980, the average outperformance over government bonds was 8.3% a year. If you were invested in the next 20-year period: 1980-2000, the average outperformance over bonds was minus 0.6% a year.

Australia was one of the best performing share markets historically, but performance has been in line with other markets since 1950.

"Thinking about equity investing using long term averages has fogged our vision about the reality of equity investments."

"It's important for investors to be aware of equity risk, but also recognise that equity investments can play an important role in investor portfolios to add diversification and growth," Cooper said.

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ABC's of the equity risk premium

*The equity risk premium (ERP) is the additional return over the government bond rate that investors demand for taking the extra risk of investing in equities.

Key points from the report

The ERP report concludes that:

- ERP is uncertain. Its timing and magnitude are unpredictable. The long run Australian historical average equity return outperformance of 5.6% a year is impressive, but the range of results over shorter, more realistic, periods is potentially less so. The report calculates the Australian historical annual equity return (out)performance over 20-year periods since 1900 in a range between 12% and minus 1.5%.
- Average Australian equity return outperformance has shrunk in recent history. It has been below its long term average since around 1990.
- Average Australian equity return outperformance for the last 20 years was only 1% a year.
- Forward-looking ERP in Australia for the next 20 years will be lower than the historical average equity return (out)performance and is estimated to be around 3.0-4.5% a year, but this is far from certain.

The complete ERP report is available at:

<www.challenger.com.au/equityriskinretirement>

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About Challenger

Challenger Limited (Challenger) is an investment management firm managing more than $59.8 billion in assets. It is focused on providing Australians with financial security for retirement.

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