The quest for wealth

The path to long-term financial security is strewn with uncertainty and complexity, but five principles can help keep you on track.

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There was a time when saving and investing for the future was considered a relatively uncomplicated affair that felt many steps removed from the intricacies of finance and global economics. Progress in recent decades – from the sophistication of everyday technology to the ready availability of round-the-clock services – has simplified many parts of our lives. But it has brought more complexity too, particularly in matters of personal finance.

Research consistently shows that many people find the decisions they need to make on saving and investing difficult, despite the profusion of information available. The paradox is that this confusion has deepened as financial services have modernised. The real danger is that people disengage from the process of how to create the wealth they need for their future.

While many things have changed, there are a number of constant principles on which investors should base their strategy to help fulfil their financial aspirations. The key rules that investors should follow in their quest for wealth are simply:

1. Make sure you have sufficient money on deposit for your short-term needs.
2. Guard against inflation.
3. Invest for the longer term.
4. Diversify your investments.
5. Find the very best managers.

Old habits

All over the developed world, savers are enduring the lowest returns on cash for centuries; but many remain wary of stock markets, despite their recovery from 2009 lows. Instead, many continue to accumulate cash; perhaps, overwhelmed by choice, it is easier to cling to old habits. But disappointing rates are expected to endure and the eventual rise will be slow and low. In such an interest rate environment, those who wish to achieve meaningful returns will need to reassess their savings on deposit.

However, cash does still play a vital role in an investment strategy, and enough should be kept on deposit. As Chris Ralph, Chief Investment Officer of St. James's Place, says: "If you maintain adequate liquidity, you should avoid the need to sell long-term investments at a bad time. As a guide, you should have enough to be able to sleep at night, and cover both expected needs and unforeseen emergencies."

Loyalty's return

Investors who hold enough cash can ignore passing market sentiment; while those with short-term horizons are more likely to be disappointed. Over the long term, investment in real assets, such as equities, provides the best chance of inflation-beating returns. When the 'dotcom bubble' burst in March 2000, global equities tumbled for three years; share prices rose until the 2008 financial crisis took markets to a low in March 2009. Since then, shares have climbed again, with ups and downs along the way, to near-record levels.

Ralph comments: "Investors cannot consistently and successfully time the markets, but those who hold assets for extended periods can reap the cumulative benefit of time's smoothing effect on market fluctuations and unforeseen events." No one knows what will happen to share prices in the short term, but those who invest over a longer period – say five years or more – are likely to be better off than they are today.

Steady attrition

One persistent obstacle that an individual will need to overcome on the road to wealth creation is inflation. Even modest levels of inflation can erode cash in a low interest rate environment. And all of us at some point in our lives are likely to live through at least one period of significant inflation.

The effects of inflation can be as severe as a sharp fall in markets. However, whereas market dips are usually followed by recoveries, inflation permanently reduces the value of your savings. While you should hold money on deposit for short-term needs, there is significant risk in trying to play safe by putting all your money into cash-like investments. When investing for the long term, you should keep an eye on inflation.

The importance of diversification

The old adage that investors should not put all their eggs in one basket still rings true. As well as the appropriate level of cash, it is important to diversify as widely as possible across different investments that can protect against inflation. "The trick is to ensure that the selection of assets won't react in the same way to market events or economic changes," says Ralph. "Just as investments will not rise at the same pace or time, you should ensure that they do not fall at the same time either."

Shares, bonds and commercial property are examples of assets that can provide growth. Investing in funds rather than individual investments also ensures that money is more widely spread. And by investing in a selection of funds that diversify across different shares, sectors and regions, as well as asset classes, investors will be better placed to withstand shifts in economic and financial conditions and achieve above-inflation returns over the long term.

Pathfinders

Different managers have different styles and assets; but many invest in the same way, so variety is no guarantee of diversity. There are a large number of fund managers to select from; some are excellent, some are very good, and some are not. "It is critical to have an investment approach that gives the best chance for your money to be with good managers," advises Ralph. "Understanding how your adviser researches, selects and monitors the fund managers should be high on your list of priorities."

There are no paths for investors that are risk-free and there probably never were. Making an informed and confident choice is not an easy task. The key to building long-term wealth is a realistic assessment of needs and goals that reflects a level of risk that feels comfortable. Individuals are often reticent about reviewing their approach to wealth creation; but advice is the key for a planned, long-term investment strategy and for peace of mind.

The value of an investment with St. James's Place will be directly linked to the performance of the funds selected and may fall as well as rise. You may get back less than the amount invested. Equities do not provide the security of capital associated with deposit accounts subject to the Deposit Insurance Systems.

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