Negative rates in Europe the X-factor of 2015

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Over the half-century I've taken an interest in investments, I have learnt and relearnt four key lessons.

1. The investment markets move in cycles. That's because, being human, we're inclined to share the optimism or pessimism of others. At times, too, the settings of monetary and fiscal policy are changed "too much and too late".

2. Investment markets often "overshoot" — that is, they move by more than changes in fundamental influences would seem to require. Perhaps the best example of the tendency within markets to overshoot can be found in exchange rate patterns.

3. There is the magic of compounding for patient investors. In other words you are rewarded for the "time in the market" as opposed to "timing the market".

4. Perhaps most relevant to today's exercise, we need to allow for the X factors — the big influences that had not been generally predicted or allowed for, but which turn up and have powerful effects on investment markets.

They occur year in year out and with equal regularity, yet the market is not able to anticipate these developments.

To be a fan of the X factor, as I have been since I first "saw the light" in 1982, does not mean copping out from taking a view on where the economy, shares, interest rates and property seem to be heading. Instead, it's a reminder that we need to allow also for the many uncertainties and surprises that are served to us.

How do we cope? Through sensible diversification, patience, and having a core holding of safe assets, which is always important for investors.

The annual X factor can be negative (the near meltdown in global banking in 2008) or positive (the collapse in Australia's trend rate of inflation in 1991).

It can be sourced from within Australia (my favourite is Paul Keating's blunt statement, as treasurer, on national radio in 1986 that Australia would become a banana republic if we didn't reform) or it may be an external event: a development such as the 9/11 terrorist attacks in the US in 2001.

This year as I assessed the field of contenders there was no lack of potential candidates. In no particular order the shortlist included:

● The annus horribilis for BHP Billiton where a severe commodity slump and a threatened dividend policy was followed by a tragic disaster at its joint venture, Samarco in Brazil.

● The sell-off in German bonds in May that raised the yield on a 10-year bond in that country from 0.08 per cent to 0.8 per cent: a development that strained Germany's relations with its EU partners.

● The disappearance of the words "Greek debt" from daily news, as the political powers in Greece somehow got through a calamitous financial situation.

● China avoiding — at least for another year — the long-predicted "hard landing".

● A better than expected growth in jobs in the US and Australia. In the US they have long passed the unemployment rate of 6.5 per cent the Fed had regarded as essential to mark an economic recovery, while in Australia our rate has slipped back beneath 6 per cent.

● The particularly boring year for gold which offered us little as an economic signal.

● Our sudden change of prime minister from Tony Abbott to Malcolm Turnbull in October.

● The limited cutbacks in supply of bulk commodities such as iron ore despite the major and sustained drop in their prices.

● The huge number of refugees fleeing the Middle East.

● The widespread experience of negative nominal interest rates, particularly in Europe, that resulted from the combination of aggressive monetary easing, the sluggish economy and market expectations of deflation. In turn, this helped bring about many interest rates in other countries falling to the lowest levels ever.

● A spectacular price surge in shares of Blackmores and Bellamy's — two stocks that produce infant formula milk — as investors enthused about Australia exporting alternative medicines and milk formula to China.

To me, the X factor for 2015 is the widespread experience of negative nominal interest rates, particularly in Europe. How unpleasant it is for savers to have to pay interest to governments or banks to have their money looked after! How hard it becomes for people trying to build up their savings to meet future needs like retirement or buying a house! And those negative rates in Europe are contributing to the puny rates of interest Australians are paid on their savings.

Next year will also have its share of surprises, from which the annual X factor for 2016 can be selected. To all who read this column, good health, good humour and good investing.

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