FINANCIAL PLANNING ADVICE

Investment forecasts predictably unpredictable

■ David Huggins

When you receive advice from your financial planner you will be given a document called a statement of advice or SOA. Many SOAs make predictions about the future performance of an investment that you are being advised to make.

It is difficult to make an accurate prediction about how an investment will perform. The reason is that the value of an investment will be affected by events that cannot be predicted — financial collapses, natural disasters or technological change.

The more complex the investment and the longer the period over which the investment is to be made, the more likely it is that a prediction about the performance of the investment will be wrong.

This uncertainty doesn't mean that you should stop investing, it just means that you have to be careful about relying on predictions when deciding to make an investment, particularly where you are going to borrow to pay for the investment.

The danger with borrowing to invest is that the loan used to pay for it will always have to be paid back in full regardless of how the investment performs. I've seen many situations where people have borrowed to invest on the basis of a wrong prediction only to be left with a worthless investment and a loan that will have to be paid back over many years or even decades.

The risk associated with borrowing to invest increases if you are relying on income from the investment to pay for the interest on the loan.

The fact that it is very difficult to accurately predict the performance of an investment is well understood in the financial planning industry.

If the value of an investment increased by 10 per cent last year, you cannot assume that it will increase by the same amount this year and you can just about be absolutely certain that its value will not increase at the same rate over a number of years.

For this reason, financial advice that is based on a prediction will almost always include a statement that you should not rely upon the prediction in making a decision about whether you should invest.

This is good advice but it raises the question of why financial planners should make any predictions at all.

You need to ask yourself whether you would be able to repay the loan if the investment went half as well as predicted and you should ask your planner explain what your position would be under a range of scenarios.

It's one thing to set out a range of possible outcomes for an investment and tell you that the actual outcome cannot be accurately predicted.

It's another thing entirely to make one prediction based upon past performance and then disclaim all liability should that prediction, almost inevitably, prove to be wrong.

■ David Huggins is a lawyer who specialises in resolving disputes about poor financial advice