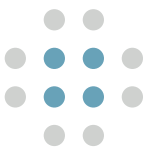

REASONS
TO STAY INVESTED
By Charles Marché

The world today may appear full of paradoxes. The outbreak of Covid-19 has led to unprecedented restrictions on personal freedoms, the shutting-down of entire sections of the economy, and a rise in job insecurity, not to mention the long-term demographic and health-related repercussions.

Even so, equity markets are currently trading at or close to all-time highs (depending on the indices) and many asset classes are now positive for the year (admittedly after very sharp drawdowns).

There are, in fact, a number of reasons to always be (or stay) invested.

Investing versus not investing: Is cash really an alternative?

Not investing is equivalent to staying in cash. While some cash is necessary for immediate spending, short-term liquidity needs, or as a safety net, pure cash has proven to be a terrible long term investment. Take, for example, US dollars, or their equivalent, Treasury bills. They have averaged less than 2% in annualised returns over the last 22 years, and less than 0.7% over the last 10 years. If that is, however, adjusted for inflation, cash has lost 1.2% per year over the past decade. A US$100 Treasury Bill investment in 1925 would be worth only $149 today, compared to $46,000 for equities (in real terms).

Bottom line: Keep some cash for expenses and as a liquidity buffer, but invest the rest. Holding cash over the long term carries a huge opportunity cost, so don't hold any more than you need.

It's about time in the market, not timing the market: How a long-term view helps

Having a long-term investment horizon helps overcome the risks and volatility associated with investing. Erratic and emotional short-term buying and selling will more often than not lead to crystallising losses and missing market recoveries. Sitting on the side-lines will lead to missing gains. Both can be extremely costly.

Chart: Low rates here for the foreseeable future

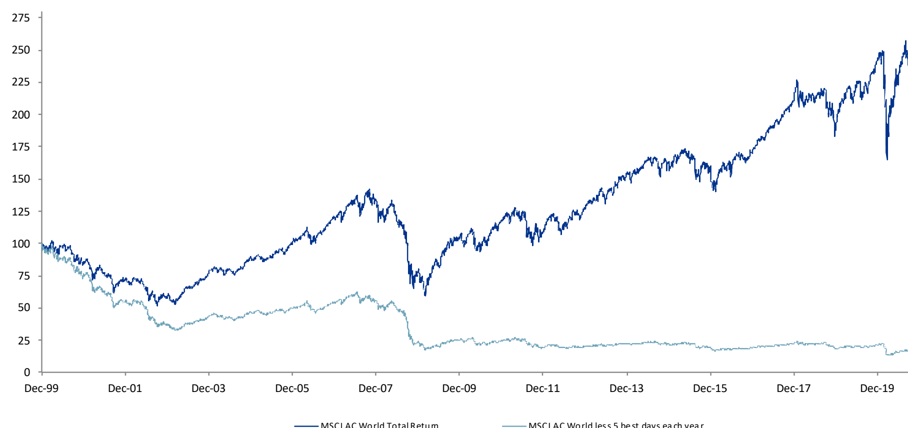

Chart 2: MSCI AC World Total Return since 2000, with and without missing the 5 best days each year

Over the past 20 years, the world has witnessed the Dot Com crash, the Great Financial Crisis, the Eurozone Crisis, Brexit, Covid-19, and countless other episodes of panic and fear. There are always reasons to sell. Yet the market has always recovered, rewarding patient investors.

Recently, drawdowns have become shorter but have also been recovered from much more quickly. Take, for example, the March 2020 correction, which wiped a third off the value of the S&P 500 in just 23 trading days. Five months later, all of that index loss had been recovered.

Bottom line: There will always be reasons to sell or panic. Having a long-term view can reward patient investors.

Staying invested is crucial: Missing just a few good days can change a lot

After sharp downwards movements, investors are prone to panic, liquidating their positions. This tends to be the worst time to sell, as days with the heaviest losses are often followed by days with the best gains. Missing these recovery days can, over time, prove to be very costly indeed.

Simply missing the five best days each year since 2000 results in an 82% loss versus a 170% gain otherwise. While some may see this as very simplistic and naïve (since being out of the market does also mean missing the down days), this approach emphasises the risk of missing recoveries.

Bottom line: Markets can move down sharply, but can also move sharply up. Failure to participate in big up-days seriously hinders recovery potential.

The power of compounding: Let your investment gains create further investment gains!

Albert Einstein reportedly said, “Compound interest is the eighth wonder of the world. He who understands it, earns it. He who doesn’t, pays it.” Whether or not he actually ever said this should not detract from the immense power of compounding. As shown below, investing over the long term allows for the compounding of gains. In essence, investment gains themselves generate further gains. The impacts are exponential over time.

Bottom line: Having a long-term view and staying invested allows for investment gains to be put to work, generating further gains.

Start	End	Drawdown	Years to Recover
24/03/2000	09/10/2002	-49.15%	4.95
17/10/2007	09/03/2009	-56.10%	3.99
21/05/2015	11/02/2016	-14.16%	0.41
20/09/2018	24/12/2018	-19.78%	0.33
19/02/2020	23/03/2020	-33.92%	0.41

Table 1: Recent S&P 500 Price Index Drawdowns and Recoveries

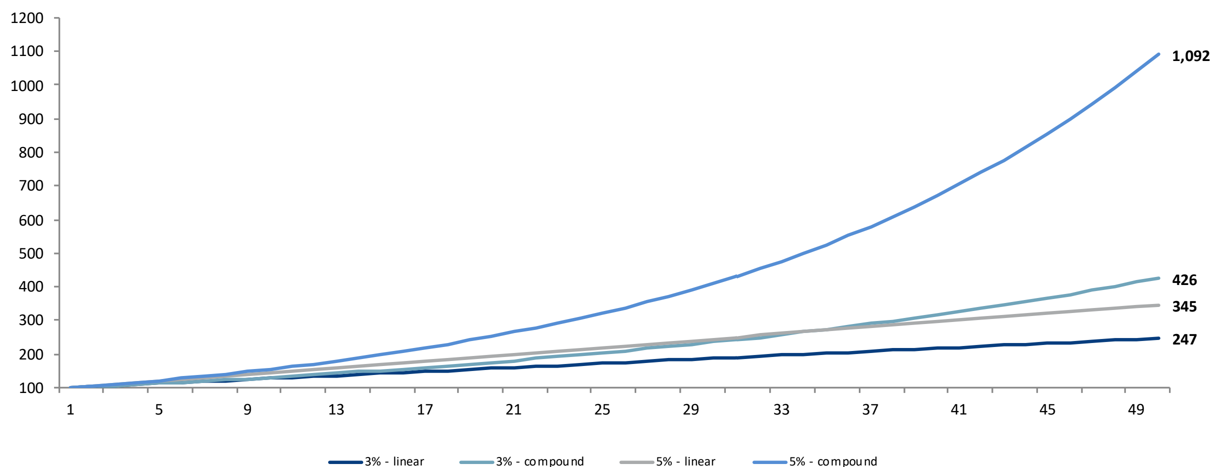

Chart 3: Linear and compound growth of US$100 at 3% and 5% rates

Dollar-cost averaging: Smooth your entry into markets

A simple solution for those worrying about entering and timing is to use 'dollar-cost averaging', whereby an investor deploys a set monetary amount into markets at regular intervals. Mathematically, more shares or investment units are bought when markets are low, and less when markets are high. Dollar-Cost Averaging also has the advantage of removing any emotional aspect: investments are done at set intervals, regardless of conditions, thus smoothing entry into markets.

Bottom line: Using a very simple dollar-cost averaging rule enables you to remove any biases and stop worrying about market timing.

Diversification is free, use it!

One of the fathers of modern portfolio theory, Harry Markowitz, once said: "Diversification is the only free lunch". Combining asset classes with different return characteristics in a diversified investment portfolio reduces significant losses.

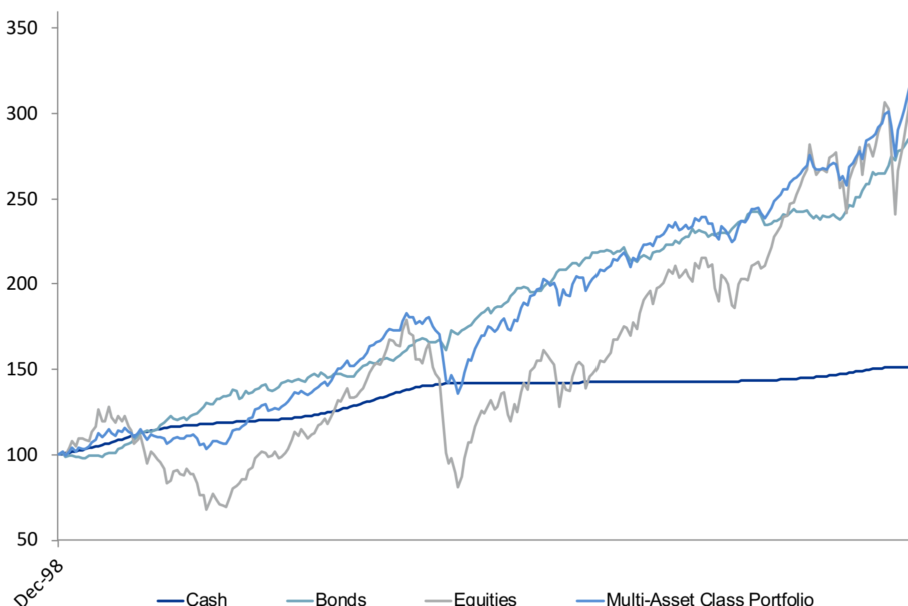

Chart 4: Cumulative returns single asset classes and multi-asset class portfolio since 1999

Over the same time period, market conditions that cause one asset class to do well often cause another to do poorly. Here, the objective is to build satisfactorily-diversified portfolios that lower overall volatility, the ultimate goal being that investors do not have to worry about inevitable market fluctuations.

Indeed, a good combination of bonds, equities, and alternative investments tends to provide better results versus a 100% equity portfolio. In fact, over the last twenty years of variable stock-market performance, multi-asset class portfolios reduced the effects of the market's losses and volatility peaks in exactly the way they were supposed to.

A multi-asset class (or 'balanced') portfolio has, on average, delivered returns of 5.7% per year, compared to equities (5.91%). In terms of risk/reward, a multi-asset class portfolio is also more efficient, generating better returns with half the volatility of a pure equity portfolio. Investors should seek to diversify beyond just equities and bonds. Incorporating a wide range of uncorrelated assets into a portfolio can further mitigate short-term market losses.

Furthermore, diversified portfolios better-protect investors during drawdowns. Smaller losses are also recovered more quickly.

Bottom line: Multi-asset class portfolios, thanks to the addition of uncorrelated assets, can add value while minimising drawdowns. Smaller drawdowns not only help you sleep better at night, but are easier to recover.

The added value of a good asset allocation process: How FAB can help you

Carefully defining a long-term strategy is paramount. FAB has adopted an asset allocation framework based on mean-variance analysis, or Modern Portfolio Theory (MPT), which optimises risk/return in a portfolio context of asset classes. While MPT's basic assumptions may have been challenged over the years, it is, and will continue to be, effective as a basic industry practice and standard.

At this point, it is important to define the asset allocation framework's long-term view. Firstly, the Strategic Asset Allocation (SAA), the 'benchmark', represents the neutral, well-diversified allocation across asset classes and their sub-classes as well as geographic regions, based on long-term assumptions about the constituent asset risks and returns.

The diversified client portfolios then deviate to a greater or lesser degree by asset class, and relative to the benchmark portfolio. For the sake of prudence, these differences versus the benchmark portfolio vary within acceptable ranges. Changes in tactical weights within portfolios are achieved smoothly, while the benchmark's constituents are reviewed annually.

Portfolio	Total Return (in %)	Average Return (in %)	Volatility (in %)	Risk/Reward Ratio
Global Equities	240.23	5.91	15.72	0.38
Multi-Asset Class Portfolio	227.64	5.72	7.11	0.81

Data from 31/12/98 to 30/11/20, rebalanced monthly

Event	Portfolio	Drawdown (%)	Recovery Time (years)
2000/2001 Crash	Global Equities	-46.8	3.3
	Multi-Asset Class Portfolio	-10.5	0.9
Global Financial Crisis	Global Equities	-53.2	4.5
	Multi-Asset Class Portfolio	-23.8	1.4
Q4 2018 Crash	Global Equities	-12.8	0.3
	Multi-Asset Class Portfolio	-4.6	0.2
Covid-19	Global Equities	-21.4	0.3
	Multi-Asset Class Portfolio	-8.2	0.2

FAB's Asset Allocation Committee (AAC) manages three different investment models, according to the following rationales and investment strategy tilts, namely:

- **Conservative:** Suitable for clients who, above all, seek to protect capital and who would otherwise be concerned should that not occur. This model portfolio tends to be composed of around 80% in defensive assets, with about 20% in growth assets.
- **Balanced:** Suitable for clients prepared to tolerate a degree of volatility in investment values. The model portfolio is made up of around 55% in defensive assets, and 45% in growth assets.
- **Growth:** Suitable for clients seeking to invest across a broad spectrum – but predominantly in growth assets – with the chance of achieving higher capital growth. The portfolio is made up of around 25% in defensive assets, and 75% in growth assets.

In addition to Strategic and Tactical Tilts, FAB investment professionals select the best vehicles to implement asset class views, through single lines, investment funds, and other structures. Over time, a robust process should result in added value at every stage, from the Strategic Asset Allocation (SAA), to the Tactical Asset Allocation (TAA), to the final client portfolio.

Through our offering of Direct Access, Advisory, and Discretionary Mandates, FAB can assist you on your investment journey. We are here to help you start investing, and to guide you in the best possible way through market cycles and crises.

Bottom line: Investment returns can be enhanced through a robust investment process. FAB can help you manage your goals and objectives in the most appropriate manner, and to structure a portfolio allocation to meet your needs.

Conclusion

Investors have no shortage of things to worry about today, not least their investment performance. While holding cash may provide an immediate sense of security, doing so carries with it the significant cost of lost opportunities over the long term. Indeed, the current global situation has thrown a spanner in the works of timing.

However, experience shows that it's not so much about timing the market: it's about time in the market – sustained time. Using a proven investment diversification process and structure, FAB's investment professionals keep their eyes on the wider horizon, helping you navigate the sometimes-rough waters of market cycles, to ensure that your investments maintain a steady overall course, and that you reach the steady shores of your long-term investment goals.