

Staying invested

Weekly Digest

9 April 2018

– Andrew Hardy (CFA)

We regularly mention our goal of ‘keeping clients invested’, but what do we mean by this? It comes down to trying to overcome the biggest obstacle preventing investors from achieving long term objectives - themselves! We are all prone to mental pitfalls which make us our own worst enemy when it comes to investing. Understanding the many behavioural risks is a valuable step in the right direction but we can never eliminate the biases.

DALBAR, Inc.* provide some sobering statistics around the impact of investor behaviour on returns. They estimate outcomes for the average equity investor by collating 30 years of data on subscriptions, redemptions and returns across all US mutual funds. The conclusion? Investors earned an average return of 3.66% per annum over the 30 year period ending December 2015, compared to the S&P 500 return of 10.35% per annum!

Several factors contribute to this outcome, including the impact of fees, other expenses, cash needs and differences in portfolio composition. However, by far the most significant driver appears to be voluntary investor behaviour and although the magnitude of the shortfall is astonishing, the underperformance makes sense. We know investors tend to pile in around market peaks and then get shaken out at the lows - equity funds saw huge inflows around the highs of the year 2000 and massive outflows around 2008 during the financial crisis, for example. The DALBAR statistics capture the effect this has on returns. The odds seem to be always against investors - average investor returns were lower than equity indices for 22 of those 30 years.

This suggests that investors tend to make irrational investment decisions, driven by herd instincts and the

emotions of greed and fear. They aim to buy low and sell high but evidence suggests that most do not practice this. Timing markets is extremely difficult and missing upswings can have a huge impact on long term returns; for example JP Morgan calculated that missing only the best ten days over the last twenty years reduces UK equity market returns from 6.3% per annum to 2.8% per annum.**

The best defence is to avoid trying to time markets and instead increase one’s time horizon as far as possible. This can be difficult given the nature of modern media, the typical economic and market debates and the structure of the finance industry, all of which leads to a short term focus. Remembering that the odds are in your favour should make the task considerably easier though; in Jeremy Siegel’s book “Stocks for the Long Run” he notes that one dollar invested in US equities in 1801 would be worth a million dollars in 2014, a return of over 7% a year above inflation.

For investment managers it is one of the stated aims to keep clients invested. Portfolio managers think the best way they achieve this is through reducing the volatility of returns. Risk for investors is the probability of not achieving their specific investment outcomes, not volatility, but volatility is the factor that is most likely to precipitate irrational decisions. Portfolio managers seek to smooth the journey for investors through careful diversification and detailed due diligence on all investment decisions. By offering a range of risk profiled portfolios we also enable investors to select a portfolio that is appropriate for their objectives and circumstances.

* The 22nd Annual Quantitative Analysis of Investor Behavior.

** JP Morgan Asset Management Guide to the Markets, Q2 2018.

The Marketplace

- Brent crude rose 6.4% last week to \$70.4 a barrel
- Gold rose 2.5% to 1,347.4 an ounce
- Global equity indices see their biggest slump in 5 weeks
- Safe haven assets gain

Market Focus

US

- The Dow Jones fell 5.7% finishing the week at 23,533
- The Fed raised rates by 0.25% on Wednesday. They're expected to rise a further three times this year
- Uber may have to rethink the amount invested into driverless technology after a pedestrian was killed in Arizona during vehicle testing. The company has also decided to pull out of South-East Asia by selling its operations in the region to rival Grab
- Manufacturing PMI rose 0.4 points but services fell a hefty 1.8 points to give a composite PMI of 54.3, down 1.4 points
- The VIX volatility index rose 5.5% to above 23 in response to market jitters
- The S&P index fell 6% to 2,588.

UK

- Upward pressure on wage growth continues. Unemployment stood at 4.3% in the three months to January, down from 4.7% a year earlier

- 'Improved equivalence' for financial services a possibility post-brexite: Luxembourg are keen proponents. However, France opposed the proposal
- The Bank of England voted to keep interest rates on hold
- The FTSE 100 fell 3.4% to 6,922
- Sterling rallied 1% after the announcement that a transition deal around Brexit had been reached.

Europe

- One in seven European companies with UK suppliers have moved part or all of their business out of Britain and relocated operations to the continent
- Manufacturing PMI for the euro area fell 2 points to 56.6, expectations were for a ½ point drop. Service PMI also fell by 1.2 points to 55 giving a composite reading of 55.3 - the lowest level since January 2017
- The Euro Stoxx 50 index fell 4% to 3298.

Asia

- China set to hit back over US trade policy with \$3 billion in tariffs on a wide range of products. There is hope that an agreement based around deficit reduction on US exports can avert the looming trade war
- The Hang Seng fell 3.8% to 30,309
- The Nikkei 225 rose 0.7% to 20,766
- Japan's manufacturing PMI declined by 0.9% to 53.2.

Asset Class/Region	Currency	Currency returns			
		Week ending 6 April 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	-1.4%	-1.4%	-2.2%	12.0%
United Kingdom	GBP	1.9%	1.9%	-5.6%	1.8%
Continental Europe	EUR	0.8%	0.8%	-2.8%	1.4%
Japan	JPY	0.2%	0.2%	-4.5%	18.6%
Asia Pacific (ex Japan)	USD	-0.6%	-0.6%	-1.1%	19.8%
Australia	AUD	0.5%	0.5%	-3.4%	3.2%
Global	USD	-0.6%	-0.6%	-1.9%	13.3%
Emerging markets equities					
Emerging Europe	USD	0.2%	0.2%	2.3%	18.8%
Emerging Asia	USD	-1.0%	-1.0%	-0.1%	25.3%
Emerging Latin America	USD	-0.1%	-0.1%	7.9%	17.9%
BRICs	USD	-0.9%	-0.9%	1.3%	27.1%
MENA countries	USD	0.4%	0.4%	7.2%	7.0%
South Africa	USD	-0.7%	-0.7%	-4.8%	26.2%
India	USD	2.5%	2.5%	-3.1%	12.5%
Global emerging markets	USD	-0.7%	-0.7%	0.7%	23.3%
Bonds					
US Treasuries	USD	-0.2%	-0.2%	-1.4%	0.1%
US Treasuries (inflation protected)	USD	0.0%	0.0%	-0.9%	0.6%
US Corporate (investment grade)	USD	0.0%	0.0%	-2.3%	2.3%
US High Yield	USD	0.3%	0.3%	-0.6%	3.8%
UK Gilts	GBP	-0.8%	-0.8%	-0.5%	-0.4%
UK Corporate (investment grade)	GBP	-0.4%	-0.4%	-1.9%	0.8%
Euro Government Bonds	EUR	-0.1%	-0.1%	1.3%	2.6%
Euro Corporate (investment grade)	EUR	0.0%	0.0%	-0.3%	1.5%
Euro High Yield	EUR	0.1%	0.1%	-0.4%	4.4%
Japanese Government	JPY	0.0%	0.0%	0.5%	1.1%
Australian Government	AUD	-0.3%	-0.3%	0.8%	2.5%
Global Government Bonds	USD	-0.4%	-0.4%	1.8%	6.9%
Global Bonds	USD	-0.2%	-0.2%	1.0%	6.8%
Global Convertible Bonds	USD	-0.4%	-0.4%	1.3%	6.8%
Emerging Market Bonds	USD	0.3%	0.3%	-1.8%	2.0%

Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-0.3%	-0.3%	-8.6%	-6.7%
Australian Property Securities	AUD	1.6%	1.6%	-5.8%	-6.0%
Asia Property Securities	USD	0.0%	0.0%	0.6%	16.1%
Global Property Securities	USD	0.1%	0.1%	-3.4%	7.2%
Currencies					
Euro	USD	-0.4%	-0.4%	2.1%	15.3%
UK Pound Sterling	USD	0.4%	0.4%	4.1%	12.9%
Japanese Yen	USD	-0.8%	-0.8%	5.1%	3.5%
Australian Dollar	USD	0.0%	0.0%	-1.6%	1.8%
South African Rand	USD	-1.8%	-1.8%	2.8%	14.4%
Swiss Franc	USD	-0.8%	-0.8%	1.4%	4.6%
Chinese Yuan	USD	-0.3%	-0.3%	3.2%	9.3%
Commodities & Alternatives					
Commodities	USD	-1.0%	-1.0%	1.1%	7.1%
Agricultural Commodities	USD	0.6%	0.6%	3.5%	0.1%
Oil	USD	-4.2%	-4.5%	0.4%	22.3%
Gold	USD	0.3%	0.3%	1.9%	6.3%
Hedge funds	USD	0.2%	0.2%	-0.8%	3.4%

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