Lync Wealth Management

The importance of remaining invested

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Introduction

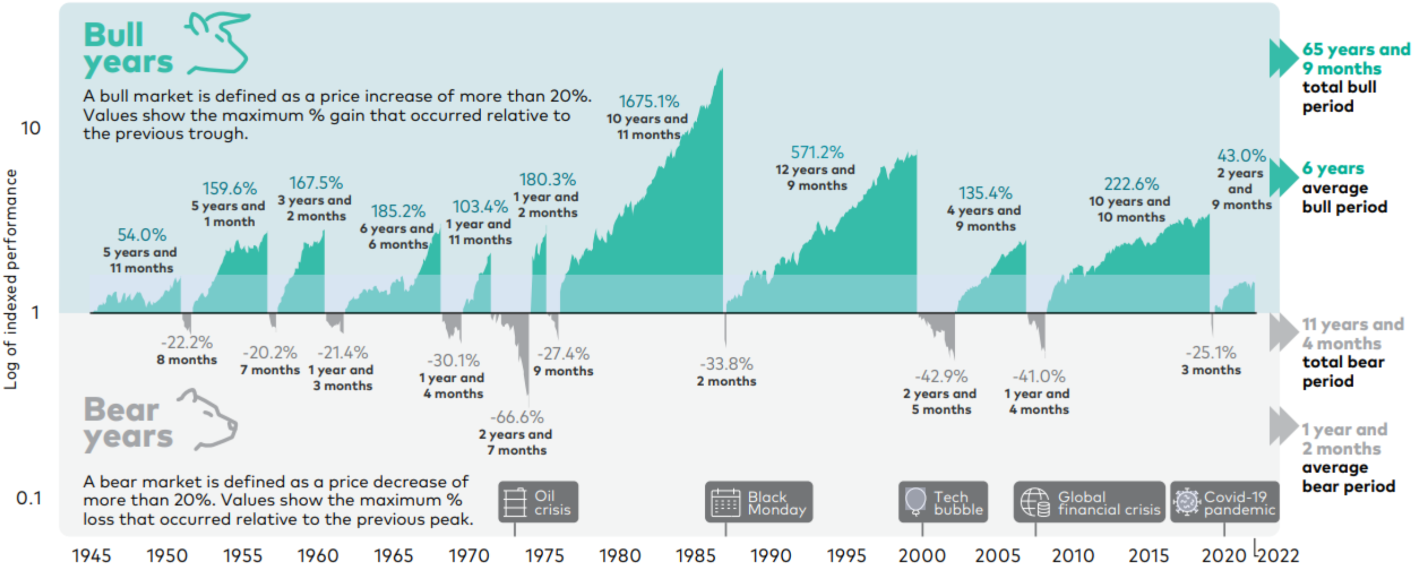
As part of the financial advice process, your Financial Adviser or Planner will no doubt speak with you about risk assets, such as stocks and shares (equities), forming part of your long-term investment plan. They will also discuss with you the risks associated with these assets and how the risks can be mitigated, depending on your tolerance for volatility (the fluctuations in the value of your investments over time).

Alongside this, they will stress that your investment strategy should be over the longer term (typically over 5 years) and, crucially, the importance of sticking to the agreed plan (unless personal circumstances dictate otherwise). Unfortunately, many private investors, particularly those without an Adviser or Planner, can sometimes react to stock market volatility at the wrong time, which results in losses being realised.

This document aims to explain how stock markets behave, what drives them, why you should ignore short term volatility and how, by sticking to the plan, your long-term investment objectives can be achieved.

We can look at the long-term nature of the stock market in terms of Bull (rising) and Bear (falling) markets over time. For the vast majority of time, stock market returns are positive, but there are occasions where they are significantly negative. Fortunately, however, these periods of negative returns are relatively short lived i.e., 1.2 years on average, so can be ridden out by sitting still. This is the reason why your investment plan is based over a longer period. Still, the extent of these falls can still be uncomfortable for many people, leading to them selling out at the wrong time, so your Adviser or Planner will look at how the impact of these falls can be reduced.

Long term stock market returns – Bear vs Bull markets



Source: Vanguard

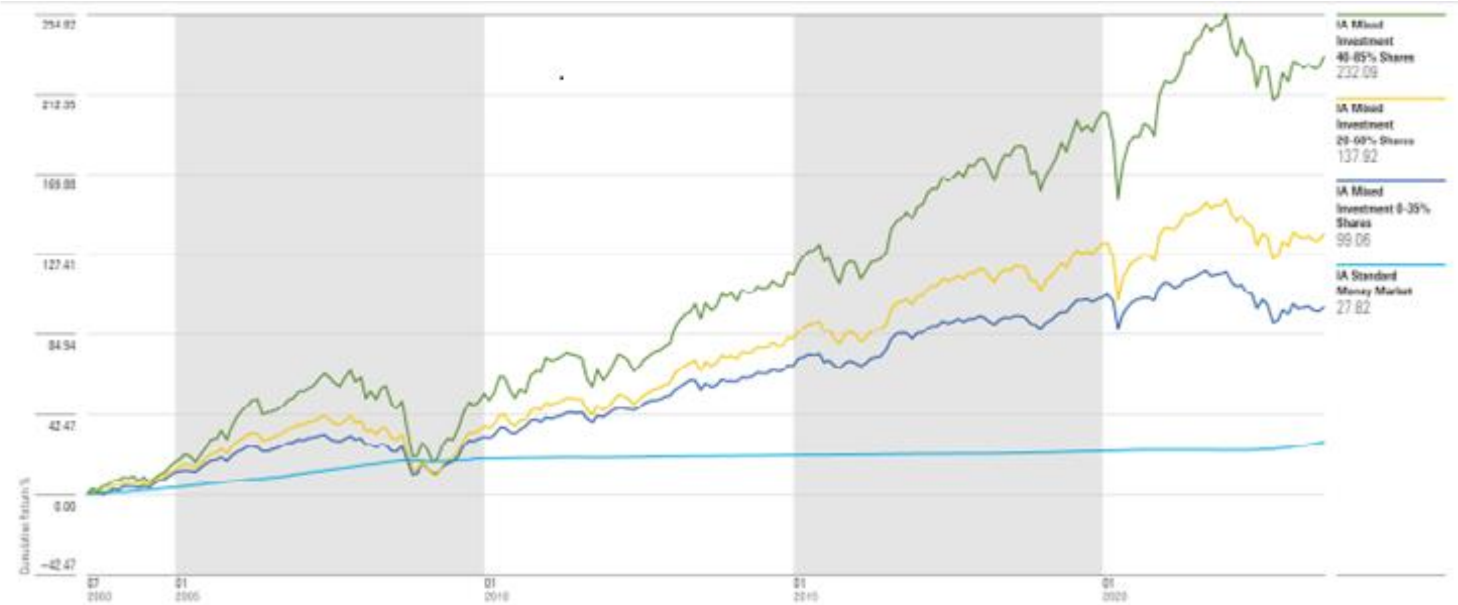
Notes: Calculations are based on FTSE All Share (GBP TR) and data aggregated from Global Financial Data. A bear (bull) market is defined as a price decrease (increase) of more than 20%. The plotted areas depict the losses / gains ranging from the minimum following a 20% loss to the respective maximum following a 20% appreciation in the underlying index. Time period: 31/12/1945 to 31/12/2022. Calculations based on monthly data. Logarithmic scale on y axis.

Source: Global Financial Data and Bloomberg

Past performance is not a reliable indicator of future results. The value of investments, and the income from them may fall or rise and investors may get back less than they invested.

Reducing the impact of the falls

The chart above is just of the UK stock market and does not include any other types of investment. Your Adviser or Planner will discuss with you the importance of diversifying your portfolio, which means including other, less risky, investments to accompany stock market-based ones. It must be understood that the level of falls that you are able to tolerate will ultimately have a bearing on the level of returns achieved.

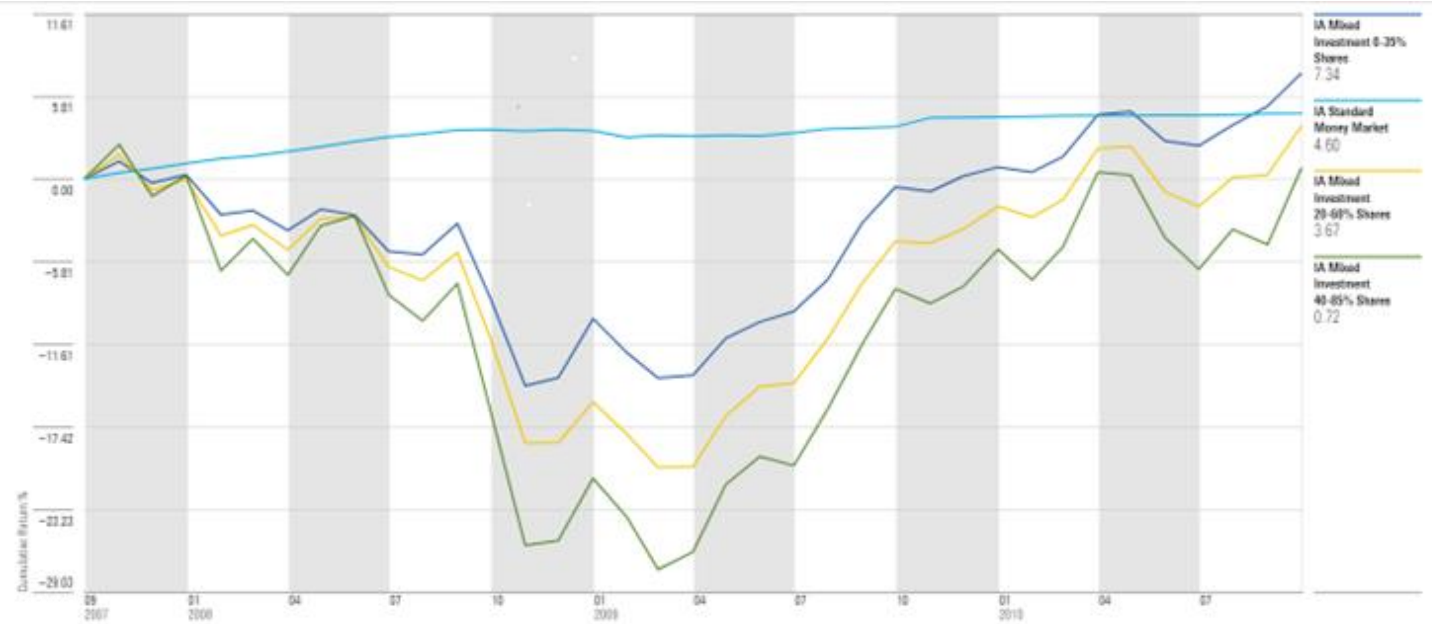


Source: Morningstar 31/07/2023

Portfolio performance show returns in GBP includes reinvestment of dividends and interest. Excludes platform fees and ongoing adviser charges.

This can be demonstrated by the difference between the returns for three fund manager industry sectors with differing level of equities: up to 85%, up to 60% and up to 35%

All of them significantly outperform the index representing money market (cash) funds, but to differing degrees. The flipside of this, is that the level of negative return during the Great Financial Crisis (GFC) in 2008/9 (the last sustained Bear market) for the higher risk Equity portfolio is greater than the Cautious.



Source: Morningstar 31/07/2023

Portfolio performance show returns in GBP includes reinvestment of dividends and interest. Excludes platform fees and ongoing adviser charges.

Looking at the second chart above, which shows the unlucky investor who managed to invest at the very top of the market in 2007. you can see the difference in the extent of level of falls between the 3 portfolios described above. The lower risk portfolios are quickest to recover their initial value, but they all recover this within around 36 months.

This demonstrates both the importance of agreeing the level of diversification in your portfolio with your adviser in the first instance and sticking with your investment plan over time.

Is the current bear market different?

The bear market at the time of writing is different from that of the GFC in that it has been triggered by an unprecedented rise in interest rates in many western economies. This has adversely affected lower risk assets, such as bonds, whose prices are very sensitive to interest rates. This has meant that lower risk portfolios have been affected as much as higher risk ones.

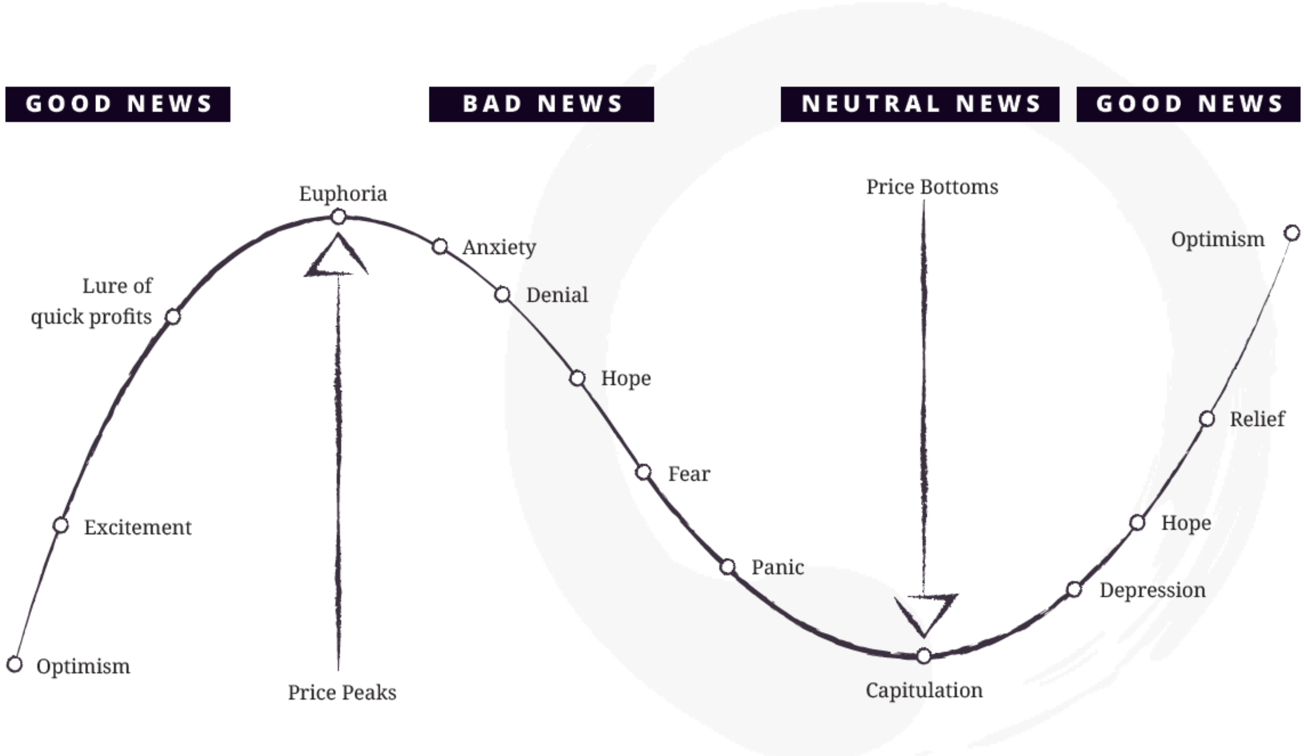
As we appear to be at or near to the peak in interest rates, the forward-looking returns from bonds appear quite attractive. However, higher risk equities are still susceptible to a slowdown in the global economy, resulting from higher interest rates and we may still not yet have seen the lows for this asset class. Therefore, the balance provided by diversification remains important.

Why do private investors tend to sell at the bottom?

So, if it is that simple, why are many private investors driven to sell when the market is in a down phase? The answer is emotions. We are all human and have certain emotional biases hard-wired into our brains.

The chart below shows the emotions experienced during differing parts of the stock market cycle and which are heavily influenced by the mainstream news. They can be useful for survival, but not for investing because they cause us to get greedy during the up phases and panic during the down phases.

Your emotions and decision-making processes during a stock market cycle



Professional investors, however, can behave differently to DIY investors. This is because they are trained in their field, generally have access to better information and, therefore, are better equipped to handle their emotions during the extremes of stock market cycles.

Academic evidence (Kaufman, 2005) shows that, as a consequence of this and as a general rule, professional investors are selling to private investors towards the top of the market and buying from them when they panic at the bottom.

So, what is the relevance of a Financial Adviser or Planner in the context of the above?

- They will make sure that your portfolio matches your tolerance for risk in the first place.
- As professionals, they generally have access to more information sources than their clients.
- They are able to ignore mainstream media 'noise', thus, they are less emotive in relation to investments as a result.
- They can help to prevent clients chasing returns in extreme 'up' market, as well as stopping them realising losses at the wrong time during 'down' markets i.e., helping them to overcome the fear accompanying market falls.

In summary, professional investors are able to help clients cope psychologically and 'stick with the plan'. When it comes to assessing the value of your Financial Adviser or Planner, their ability to help you cope with the ups and downs of risk-based investments is one of the most significant contributions to that value.

There is increasing evidence to suggest that, when it comes to assessing the value of your Financial Adviser or Planner, their ability to help you cope with the ups and downs of risk-based investments is one of the most significant contributions to that value (See Vanguard's 'Adviser Alpha', University of Montreal 'the value of advice', et al).

Asset class performance

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD	Q2 '23
MSCI Asia ex-Japan 22.7%	Japan TOPIX 54.4%	US S&P 500 13.7%	Japan TOPIX 12.1%	UK FTSE All-Share 16.8%	MSCI Asia ex-Japan 42.1%	US S&P 500 -4.4%	US S&P 500 31.5%	MSCI Asia ex-Japan 25.4%	US S&P 500 28.7%	UK FTSE All-Share 0.3%	Japan TOPIX 22.7%	Japan TOPIX 14.4%
Japan TOPIX 20.9%	US S&P 500 32.4%	Japan TOPIX 10.3%	MSCI Europe ex-UK 9.1%	US S&P 500 12.0%	MSCI EM 37.8%	UK FTSE All-Share -9.5%	MSCI Europe ex-UK 27.5%	MSCI EM 18.7%	MSCI Europe ex-UK 24.4%	Japan TOPIX -2.5%	US S&P 500 16.9%	US S&P 500 8.7%
MSCI Europe ex-UK 20.0%	MSCI Europe ex-UK 24.2%	MSCI Europe ex-UK 7.4%	US S&P 500 1.4%	MSCI EM 11.6%	Japan TOPIX 22.2%	MSCI Europe ex-UK -10.6%	UK FTSE All-Share 19.2%	US S&P 500 18.4%	UK FTSE All-Share 18.3%	MSCI Europe ex-UK -12.2%	MSCI Europe ex-UK 13.8%	MSCI Europe ex-UK 3.0%
MSCI EM 18.6%	UK FTSE All-Share 20.8%	MSCI Asia ex-Japan 5.1%	UK FTSE All-Share 1.0%	MSCI Asia ex-Japan 5.8%	US S&P 500 21.8%	MSCI Asia ex-Japan -14.1%	MSCI EM 18.9%	Japan TOPIX 7.4%	Japan TOPIX 12.7%	US S&P 500 -18.1%	MSCI EM 5.1%	MSCI EM 1.0%
US S&P 500 16.0%	MSCI Asia ex-Japan 3.3%	UK FTSE All-Share 1.2%	MSCI Asia ex-Japan -8.9%	MSCI Europe ex-UK 3.2%	MSCI Europe ex-UK 14.5%	MSCI EM -14.2%	MSCI Asia ex-Japan 18.5%	MSCI Europe ex-UK 2.1%	MSCI EM -2.2%	MSCI Asia ex-Japan -19.4%	MSCI Asia ex-Japan 3.2%	UK FTSE All-Share -0.5%
UK FTSE All-Share 12.3%	MSCI EM -2.3%	MSCI EM -1.8%	MSCI EM -14.6%	Japan TOPIX 0.3%	UK FTSE All-Share 13.1%	Japan TOPIX -16.0%	Japan TOPIX 18.1%	UK FTSE All-Share -9.8%	MSCI Asia ex-Japan -4.5%	MSCI EM -19.7%	UK FTSE All-Share 2.6%	MSCI Asia ex-Japan -1.1%

The table above shows, in an intuitive way, the performance of different asset classes over 11.5 years.

What does this table tell us?

Asset classes' performance varies significantly from year to year.

Diversification is key: It is a high-risk strategy to pin your investment strategy on one or two asset classes in the hope that they might be next year's winner; they could also be next year's loser. Holding a range of these assets spreads your risk. However, the proportions will be decided by your attitude to risk.

Market capitalisation should not be ignored: the largest market in the world, US large cap (S&P 500), has been in the top half over most periods. If you are 'tilting' your asset allocation, it is important to have a forward-looking view in order to capture the potential returns of those performing assets and reduce the impact of the underperforming ones.

Not many asset classes that have performed well in the previous year, do so the next year, so looking back can be perilous (e.g., Asia ex-Japan – top left to bottom right).

Having a bias to your domestic market (so called, home bias) at all times, can lead to allocation to underperforming assets: the UK has been out of the top half more than it has been in it and has often been the bottom performer.

All Rockhold portfolios have diversification and risk management at their core. Using a forward-looking investment process, our investment managers will tilt the portfolios based on their years of experience, whilst maintaining diversification. The intention being to reduce exposure to the assets that are likely to drag on performance in the coming year and increase exposure to those asset classes that are likely to make a positive contribution.

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Important information

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