SANTANDER ASSET MANAGEMENT UK

ABOUT INVESTMENTS

Investing for all seasons

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Many investors rely on exposure to both bonds and shares to help manage their investment risk. Is this good enough to help keep your investments on track, no matter what the season?

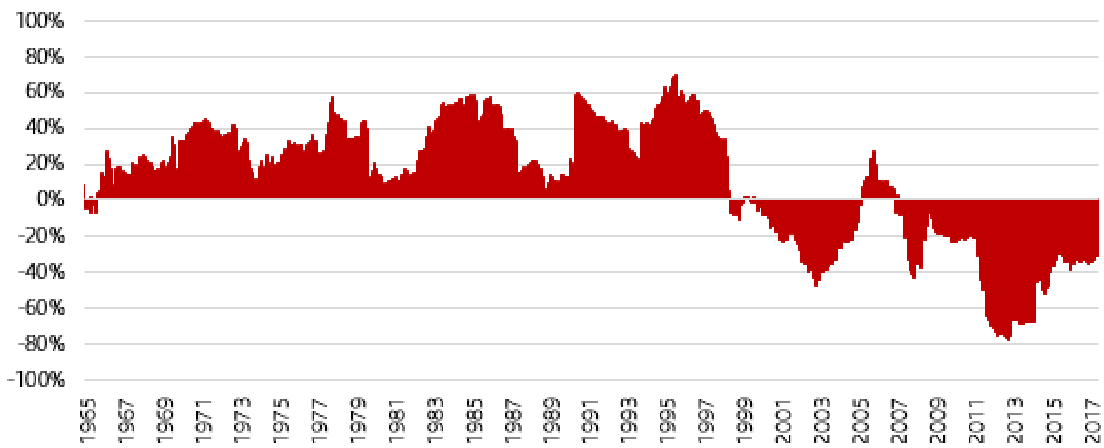
This traditional approach to managing risk is based on the idea that bonds and shares usually behave differently, rarely moving up or down together at the same time.

Fact or fiction?

A look at the facts, though, suggests it might be a mistake to take this behaviour for granted.

Here's just one example of how shares (represented by the S&P 500 Total Return index) and government bonds (represented by US 10 Year Treasury bonds) performed over the past 50 years or so. Anything above the 0% line shows that bonds and shares moved in a similar direction to some degree. Below the 0% line the opposite was true.

How differently have shares and bonds performed?



Source: Santander Asset Management, Bloomberg, November 2018. This chart shows the 3-year rolling correlation between the performance of the S&P 500 Total Return index and US 10 Year Treasury bonds

It's clear to see that, until the late 1990s, these particular shares and bonds were behaving more similarly than you might expect. Recent research by Winton, an investment management and data science group, found similar results looking at a range of markets around the world.[1]

Furthermore, even if shares and bonds had historically always behaved differently, we know that past performance is not a guide to future performance. Recent increases in inflation, interest rates and more frequent ups and downs in the prices of shares may increase the chance of a bond sell-off happening at the same time as a downturn in the shares markets.

What does the future hold?

The Organisation for Economic Cooperation and Development (OECD) cut its growth forecasts for several western and developing countries in September 2018, warning that global economic growth may have peaked. It pointed to developments including the escalating US-China trade war, Brexit uncertainty, concerns about the Italian banking system and economic turbulence in countries such as Turkey and Argentina.

It added that "A decade after the financial crisis, vulnerabilities remain in financial markets from elevated asset prices and high debt levels". [2]

The OECD went further last November, warning of a growing risk that higher barriers to trade, capital outflows from developing economies and higher oil prices could slow the global economy sharply. [3]

These types of warnings have been issued several times over the past couple of years, not least in 2016 following the EU Referendum and Donald Trump's US election victory, and yet a serious downturn remained elusive. Is it different this time? Is a lasting downturn finally on the way? One that might impact shares and bonds at the same time?

One thing you can guarantee is that, whilst we can use our skills and experience to make predictions, no-one can be completely sure what will happen tomorrow. So, if you're thinking of investing, or already are, what can you do to make sure your risks are managed as effectively as possible, however the investing season turns?

Investing for all seasons

This is where multi-asset funds can come in. As they can help you to manage your risk in different and potentially more effective ways than the traditional split between shares and bonds. They do this by spreading your money across other types of investment. That might include property, cash and alternative investments like foreign exchange strategies, hedge funds, derivatives, infrastructure investments and private equity.

Investments will always go down as well as up, but no matter what the investing season, multi-asset funds, aim to spread your risk as effectively as possible using all the investment tools at their disposal.

They come in lots of different shapes and sizes and can help you to invest for growth over the longer-term, to generate an income or even a mix of both.

[1] **Source:** https://www.winton.com/research/challenging-equity-bond-correlation-assumptions

[2] **Source:** https://www.theguardian.com/business/2018/sep/20/global-growth-has-peaked-warns-oecd-economic-outlook

[3] **Source:** https://www.wsj.com/articles/with-central-banks-out-of-ammo-governments-urged-to-ready-stimulus-for-next-downturn-1542794400

Let's be clear!

Investment terms explained

Alternatives: Any investment other than equities and fixed income, such as property and absolute return funds.

Asset class: A group of investments with similar traits. Shares, bonds, property, cash and alternatives are all examples of asset classes.

Bonds: A bond is a loan issued by a government or a company. When you buy a bond, the issuer promises to pay a certain amount of income until the bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the bond. This is known as creditworthiness.

Derivative: A financial security that is traded between two parties and that gets its value from how an underlying investment or group of investments performs.

Diversification: Spreading your money across different investments to help manage risk.

Dividend: The income you can earn from equities.

Hedge fund: A type of investment fund that uses sophisticated techniques to try and generate better returns. Hedge funds use derivatives and often borrow to help meet their aims.

Index: A way of tracking the overall performance of a basket of individual investments of a similar type. For example, the FTSE 100 index tracks the performance of shares in the 100 largest companies by market value on the London Stock Exchange.

Inflation: Measures the increase in price of selected goods and services in an economy over a period of time.

Infrastructure: Infrastructure investments are investments in the physical systems of a business or nation, like roads, other transport networks and water and electric systems.

Investment risk: The uncertainty that goes with inve sting and that means investments can go down in value as well as up.

Private equity: Investments in private companies that are not traded on a stock exchange and so aren't as easy to buy or sell when you want to.

Shares: Often referred to as equities or stocks; in investing, this is a share of ownership in a company. Investing in a fund gives exposure to underlying share prices without investors actually owning the shares themselves.

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