Santander Asset Management

# State of Play

## Back to investment principles

**29 July 2022**

**If we reflect on the journey for investors over the first half of this year, it could be easy to become fearful and question whether investing is the right thing to do for you, given the uncertainty, falls in value and extreme volatility. However, if we return to the principles of investing it isn't about days, it's about decades. Our Senior Investment Specialist, Simon Durling, shares his thoughts in this week's State of Play.**

## Bumpy ride

For the most part, this year has seen falls in the majority of asset classes, as central banks have increased interest rates in an attempt to cool inflation. This has triggered rises in bond yields, which in turn causes bonds to lose value. As borrowing and raw material costs have risen, investors have re-priced company shares to reflect the pressure on future revenue streams as profit margins are squeezed.[1] It would be very easy for investors to become nervous about investing, either questioning a recent decision to invest or for those who have yet to implement long-term plans, to wait and see in case things get worse before they get better. It is at times like these that it is worth revisiting the principles of investing and why it usually makes sense to consider a long-term plan or to remain invested, assuming this is appropriate for your circumstances.

## Striking the right balance

Savings and investments both have an equally important role to play in building an appropriate long-term plan, to find the right balance for you and your money. That balance will depend on your circumstances, your goals, and your timescales. Saving is mainly about keeping your money both safe and accessible for emergencies and short-term goals. Investing, on the other hand, is typically about growing your money over the long-term, using it to generate an income or a mixture of both.

One of the many motivation's investors might have is to try to grow their wealth in real terms, which means achieving a level of return in excess of inflation. Up until very recently this has been much easier as inflation has been below the long-term historical average.[2] Now that we are faced with the cost-of-living crisis and inflation is nearing double digits, trying to protect the purchasing power of your wealth has arguably never been more important.

That means taking a more long-term view and, if appropriate, taking some additional risk. That being said, there are investment solutions which are spread across a range of asset classes, which usually helps to balance some of this risk. Let's explore the relationship between risk and return.

## Risk vs return

Investments always come with some level of risk. Even savings, based on the current very low interest rates, carry inflation risk. This is due to the rate of interest failing to keep pace with rising prices, so the real value of your money reduces over time. When taking investment risk you are likely to experience market values going down as well as up and there is always a chance you will lose some or all your money. To help mitigate some of this risk, it usually pays to spread your investments across different types of asset classes through diversification (which I explore in the next section). However, having a diversified portfolio doesn't mean that your investments won't fall in value or that you can't lose money. What it does mean is that usually in normal market conditions your investments are unlikely to all lose or gain value to the same degree at the same time. That helps limit your risk of losses, while keeping some potential for growth.

Importantly there are some key considerations you need to think through when assessing investment risk.

- Firstly, how much risk you are willing to take? That's what you're comfortable with and won't keep you awake at night.
- Secondly, how much risk you can afford to take? That's how much money you could afford to lose without putting your current lifestyle and future goals in jeopardy.
- And lastly, how much risk you need to take? That's linked to how much investment growth you need, based on your current plans, to achieve your goals.

This last part is important. If your attitude to investing does not align to the risk required to achieve your long-term goals, you may have to compromise on your goals and expectations.

## Diversification matters

Assets like shares, bonds, property, and cash behave differently at different times depending on what factors are influencing the markets at any given time. What causes one asset to fall in value may cause another to gain value, so when some of your assets lose value, others are likely to be doing better. If one asset moves or responds in a similar way to another they are said to be positively correlated. If they move or respond differently, they are seen as negatively correlated. Making sure your portfolio is made up of investments which are negatively correlated usually means there is less chance they will all go up or down to the same degree at the same time, helping to smooth your investment journey.

Looking at the bigger picture, here you can see how different asset classes performed from 2012 to 2021. Remember past performance is not a guide to future performance. The detail of what's covered by each box in the grid is less important than the fact there's a great deal of variation – both in terms of how each asset class has performed over time and how they compare to one another.

### Year-on-year ranking of asset classes

| Performance ranking | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| Highest | 19.4% Europe Excl. UK Shares | 30.6% North America Shares | 17.8% North America Shares | 16.2% Japan Shares | 31.6% Global Emerging Market Shares | 25.3% Asia Pacific Excl. Japan Shares | 2.9% UK Direct Property | 24.6% North America Shares | 19.9% Asia Pacific Excl. Japan Shares | 25.2% North America Shares |
| | 16.6% Asia Pacific Excl. Japan Shares | 26.5% UK All Companies Shares | 14.9% UK Government Bonds | 9.4% Europe Excl. UK Shares | 30.1% North America Shares | 24.5% Global Emerging Market Shares | 2.7% Global Government Bonds | 22.4% UK All Companies Shares | 16.5% North America Shares | 17.1% UK All Companies Shares |
| | 15.4% UK All Companies Shares | 26.3% Europe Excl. UK Shares | 12.2% UK Direct Property | 7.6% UK Direct Property | 26.0% Asia Pacific Excl. Japan Shares | 17.8% Japan Shares | 0.4% Standard Money Market | 20.4% Europe Excl. UK Shares | 13.9% Japan Shares | 15.6% Europe Excl. UK Shares |
| | 14.3% Sterling Corporate Bonds | 26.1% Japan Shares | 10.6% Sterling Corporate Bonds | 5.0% UK All Companies Shares | 24.3% Global Emerging Market Bonds | 17.5% Europe Excl. UK Shares | -0.1% UK Government Bonds | 17.1% Japan Shares | 13.6% Global Emerging Market Shares | 7.4% UK Direct Property |
| | 13.6% Global Emerging Market Shares | 7.9% UK Direct Property | 9.7% Asia Pacific Excl. Japan Shares | 4.5% North America Shares | 23.6% Japan Shares | 14.1% UK All Companies Shares | -1.2% North America Shares | 15.8% Asia Pacific Excl. Japan Shares | 10.5% Europe Excl. UK Shares | 1.6% Japan Shares |
| | 12.6% Global Emerging Market Bonds | 1.9% Asia Pacific Excl. Japan Shares | 8.7% Global Corporate Bonds | 1.1% Global Corporate Bonds | 17.1% Europe Excl. UK Shares | 10.5% North America Shares | -1.7% Global Corporate Bonds | 15.7% Global Emerging Market Shares | 9.0% UK Government Bonds | 1.5% Asia Pacific Excl. Japan Shares |
| | 7.5% North America Shares | 1.3% Sterling Corporate Bonds | 6.2% Global Government Bonds | 0.5% Global Government Bonds | 14.8% Global Government Bonds | 7.6% UK Direct Property | -2.2% Sterling Corporate Bonds | 10.2% Global Emerging Market Bonds | 7.9% Sterling Corporate Bonds | -0.1% Standard Money Market |
| | 7.2% Global Corporate Bonds | 0.2% Standard Money Market | 3.4% Global Emerging Market Shares | 0.2% Standard Money Market | 13.4% Global Corporate Bonds | 5.4% Global Emerging Market Bonds | -3.7% Global Emerging Market Bonds | 9.5% Sterling Corporate Bonds | 7.0% Global Corporate Bonds | -0.3% Global Emerging Market Shares |
| | 3.3% Japan Shares | -0.7% Global Corporate Bonds | 3.4% Global Emerging Market Bonds | 0.2% Sterling Corporate Bonds | 11.4% UK Government Bonds | 5.2% Sterling Corporate Bonds | -9.8% Asia Pacific Excl. Japan Shares | 8.4% Global Corporate Bonds | 5.6% Global Government Bonds | -0.8% Global Corporate Bonds |
| | 2.0% UK Government Bonds | -3.8% Global Emerging Market Shares | 0.9% UK All Companies Shares | 0.0% UK Government Bonds | 11.0% UK All Companies Shares | 3.3% Global Corporate Bonds | -11.2% UK All Companies Shares | 7.2% UK Government Bonds | 3.5% Global Emerging Market Bonds | -2.0% Sterling Corporate Bonds |
| | 1.9% Global Government Bonds | -4.0% Global Government Bonds | 0.4% Japan Shares | -2.8% Asia Pacific Excl. Japan Shares | 9.7% Sterling Corporate Bonds | 1.7% UK Government Bonds | -11.3% Japan Shares | 3.4% Global Government Bonds | 0.5% Standard Money Market | -3.7% Global Emerging Market Bonds |
| | 1.5% UK Direct Property | -4.9% UK Government Bonds | 0.3% Standard Money Market | -5.1% Global Emerging Market Bonds | 0.3% Standard Money Market | 0.1% Standard Money Market | -11.5% Global Emerging Market Shares | 0.7% Standard Money Market | -3.8% UK Direct Property | -5.3% UK Government Bonds |
| Lowest | 0.5% Standard Money Market | -9.2% Global Emerging Market Bonds | -0.9% Europe Excl. UK Shares | -9.2% Global Emerging Market Shares | -2.0% UK Direct Property | -1.1% Global Government Bonds | -12.2% Europe Excl. UK Shares | -0.8% UK Direct Property | -6.2% UK All Companies Shares | -5.3% Global Government Bonds |

*Source: Morningstar, based on the Investment Association sector average returns. Data as at 30 June 2022.*

# Modern Portfolio Theory

In 1952, US economist Harry Markowitz was the first to propose the importance of asset mix to investment outcomes.[3] He received a Nobel prize for his Model Portfolio Theory, which still influences how we invest today.[3]

It states that a portfolio of different, unrelated (diverse and uncorrelated) assets is the best way to maximise returns for any given level of risk.[3]

## History teaches us it is time in the markets

Regardless of your level of expertise no-one can know what the long-term future outcomes will be. However, history does teach us that over the long-term it's generally better to stay invested through the downs as well as the ups. Over time, investment market growth tends to balance out the short-term volatility. The chart below plots some of the key events which have triggered market downturns, only for markets to then recover over time. It demonstrates that investors who remained invested throughout captured upturns in value. Often sharp falls in value can often be followed by short but significant increases that would be missed if an individual attempted to try and time these changes. Even professional fund managers typically do not attempt to try, so it makes sense for retail investors to avoid trying to take the risk.

This chart shows the performance of the MSCI World Index since January 1990 with some key events highlighted.


*Source: MSCI World Index and Refinitiv Datastream. Data as at 30 June 2022.*

Of course, looking at the data like this is very different to watching the impact on your own investments. And when emotions run high it can be tempting to make short-term decisions in response, which you could later regret. Stifling these instincts isn't easy. It's important to take steps to put aside savings for emergencies and short-term needs before deciding to invest, this can help to avoid unnecessarily encashing investments at the wrong time. That's why it can be helpful to have the support of a team of objective, skilled professionals.

## You're only human

Research by behavioral psychologists has shown that investors tend to feel the pain of losses more keenly than the pleasure of equal gains. That might lead you to sell in a falling market and make your losses real.

Another very human trait is to do what everyone else is. That might lead you to put money into investments with already high prices, driven up by demand, and that rationally offer little room for further growth.

If you're invested in a risk-managed or targeted multi-asset fund or a model portfolio service, for example, the fund managers will keep a close eye on the markets. As market conditions change, they will adjust your investment to keep it running in line with the balance of risk and reward you first chose it for. A financial adviser can help you to see how market fluctuations might affect you based on your goals, your timescales and how much risk you want to take and can afford to take.

## The importance of reviewing your long-term plan

Remember, your investment goals and objectives may change so reviewing your portfolio regularly is a good idea. It often pays to ignore short-term headlines and uncertainty, sticking with your long-term plan designed to help you achieve your investment goals. But, of course, there are exceptions. If you're unsure about investing or worried about your investment portfolio, a financial adviser can help you weigh everything up, based on your own personal circumstances, and help you make the right decisions for you.

## Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing **here**.

Note: Data as at 26 July 2022.

[1] FE Analytics and Investing.com, 26 July 2022
[2] Office for National Statistics, 20 July 2022
[3] Investopedia, 5 May 2022

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