Financial Planning Wales
Risk & Returns

UNDERSTANDING WHAT TO EXPECT FROM INVESTING

Annual Returns From Major Asset Classes Since 2005

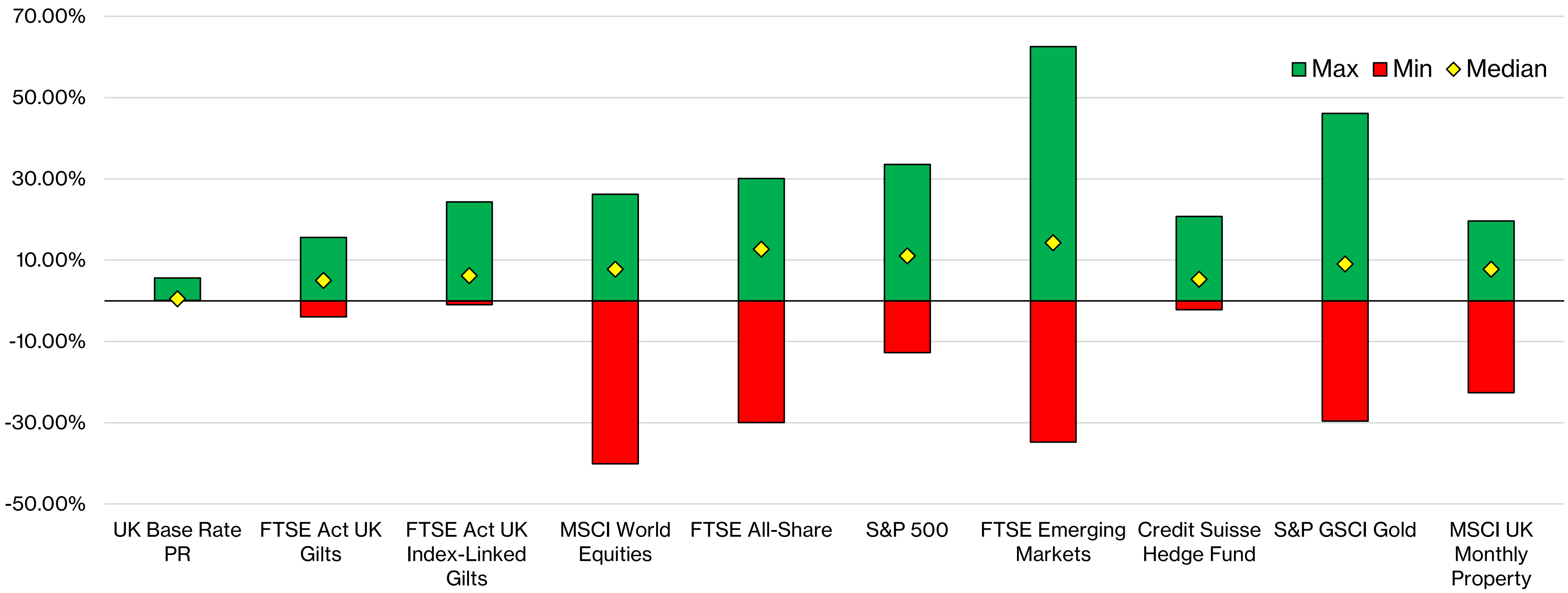
In the last fifteen years ultra-low interest rates have made Cash one of the most unpopular assets to own; Emerging Markets have offered the best returns on five occasions.... but also the worst twice. The table below shows us the variability of returns from different asset classes and the difficulty of consistently picking the best or worst performing.

Investment Name	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
UK Base Rate PR	4.65%	4.65%	5.50%	4.62%	0.62%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.40%	0.29%	0.60%	0.75%	0.12%
UK Gilts	7.93%	0.69%	5.27%	12.81%	-1.16%	7.20%	15.57%	2.70%	-3.94%	13.86%	0.57%	10.10%	1.83%	0.57%	6.90%	4.83%
UK Index-Linked Gilts	8.97%	2.89%	8.45%	3.72%	6.45%	8.88%	19.94%	0.63%	0.54%	18.96%	-0.97%	24.33%	2.34%	-0.28%	6.42%	5.96%
MSCI World Equities	13.74%	13.52%	2.83%	-40.11%	22.82%	7.83%	-7.56%	13.07%	26.25%	7.71%	0.15%	6.77%	16.27%	-9.13%	24.86%	-8.53%
FTSE All-Share	22.04%	16.75%	5.32%	-29.93%	30.12%	14.51%	-3.46%	12.30%	20.81%	1.18%	0.98%	16.75%	13.10%	-9.47%	19.17%	-11.85%
S&P 500	17.33%	1.57%	3.72%	-12.77%	12.59%	18.68%	2.87%	10.91%	29.93%	20.76%	7.26%	33.55%	11.28%	1.56%	26.41%	-4.86%
FTSE Emerging Markets	51.09%	16.77%	37.38%	-34.78%	62.54%	23.58%	-18.36%	12.76%	-5.29%	7.87%	-10.31%	35.43%	21.06%	-7.63%	15.91%	-5.99%
Credit Suisse Hedge Fund	20.34%	-0.12%	10.67%	12.05%	5.57%	14.44%	-1.79%	2.94%	7.69%	10.61%	5.04%	20.77%	-2.16%	2.83%	5.09%	1.81%
S&P GSCI Gold	32.37%	7.85%	29.14%	46.10%	10.37%	33.74%	11.05%	2.26%	-29.59%	4.61%	-5.28%	29.58%	3.84%	3.94%	14.28%	6.68%
MSCI UK Monthly Property	19.64%	18.34%	-5.36%	-22.63%	1.89%	14.71%	8.11%	2.31%	11.02%	19.46%	13.89%	2.63%	11.24%	7.45%	2.11%	0.54%

Source Morningstar Adviser Workstation (26-03-20)

Return Ranges From Major Asset Classes Since 2005

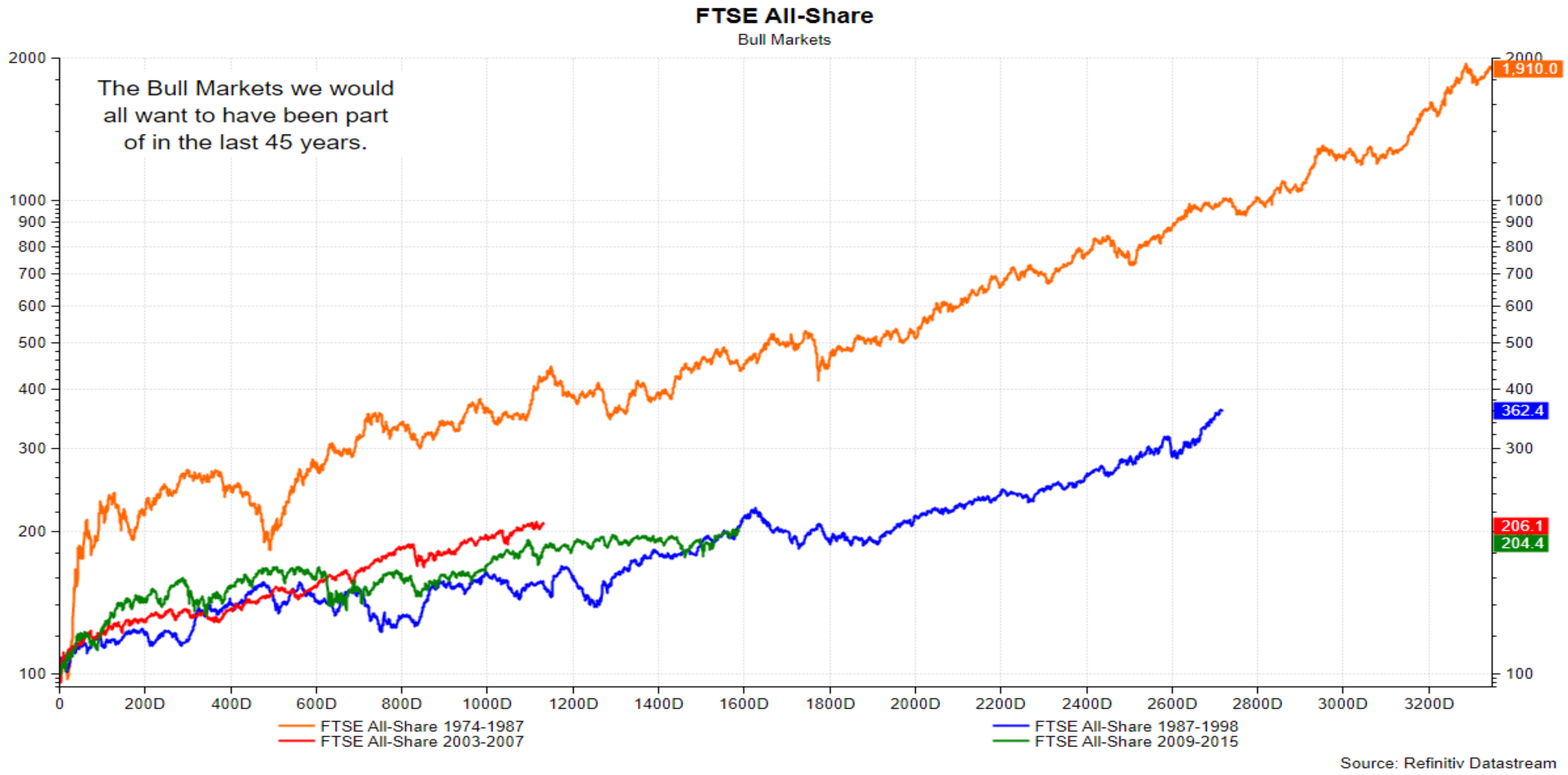
Volatility – the variation in prices – typically brings the opportunity for greater returns, but this is not always guaranteed! The median return is a good measure of the long term performance that you should expect; those assets with a wider range offer opportunities to win or lose big whether that is from judicious choices or pure luck.



Source Morningstar Adviser Workstation (26-03-20)

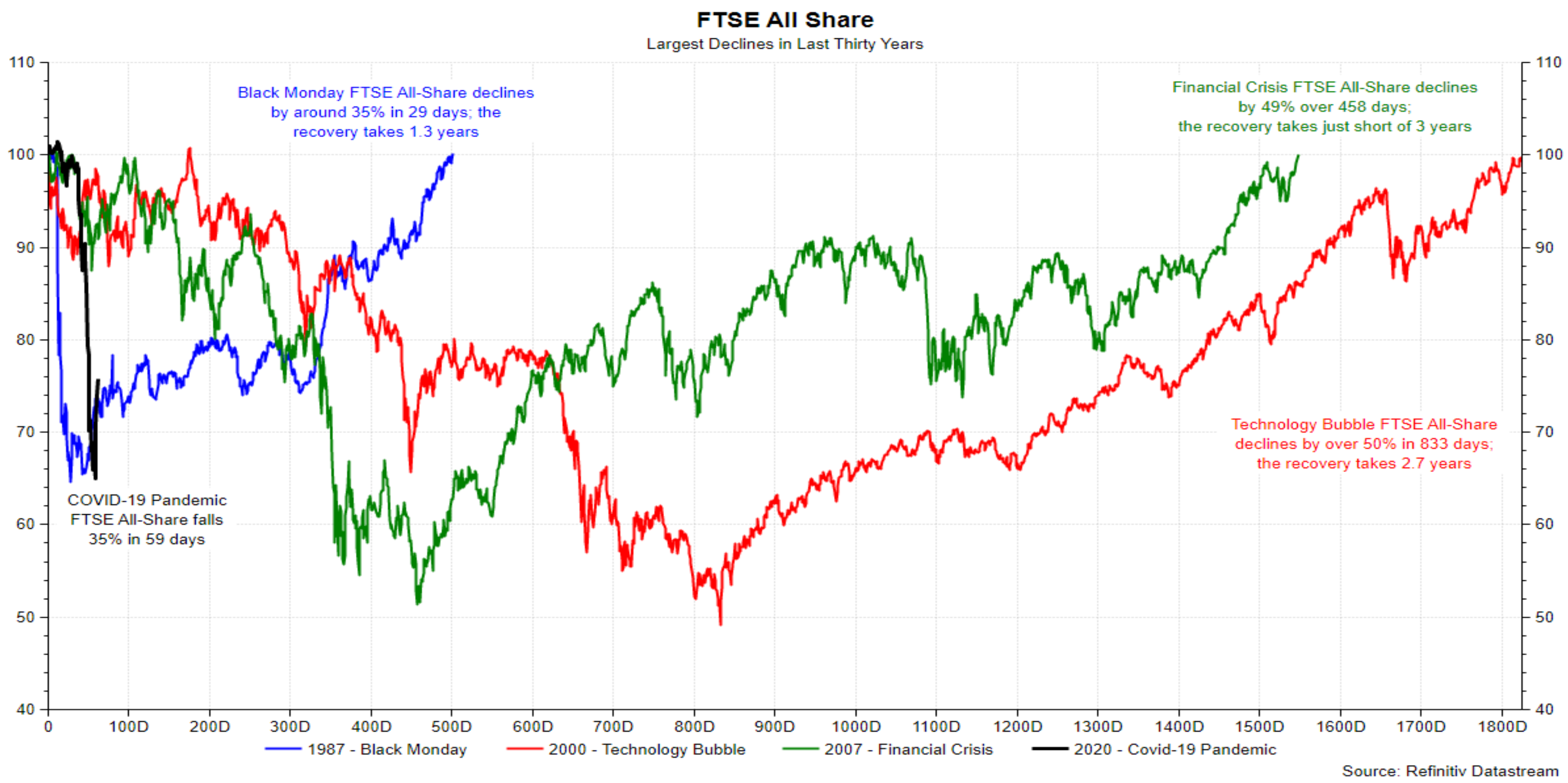
Where You Start Investing Matters.....A Lot!

Investor returns are heavily influenced by the time that they start; those that enjoy the best returns will have become investors at market lows. Investing in the FTSE All-Share in 1974, 1987, 2003 and 2009 was only for the brave who had cash available and even then the investment road was long and bumpy.



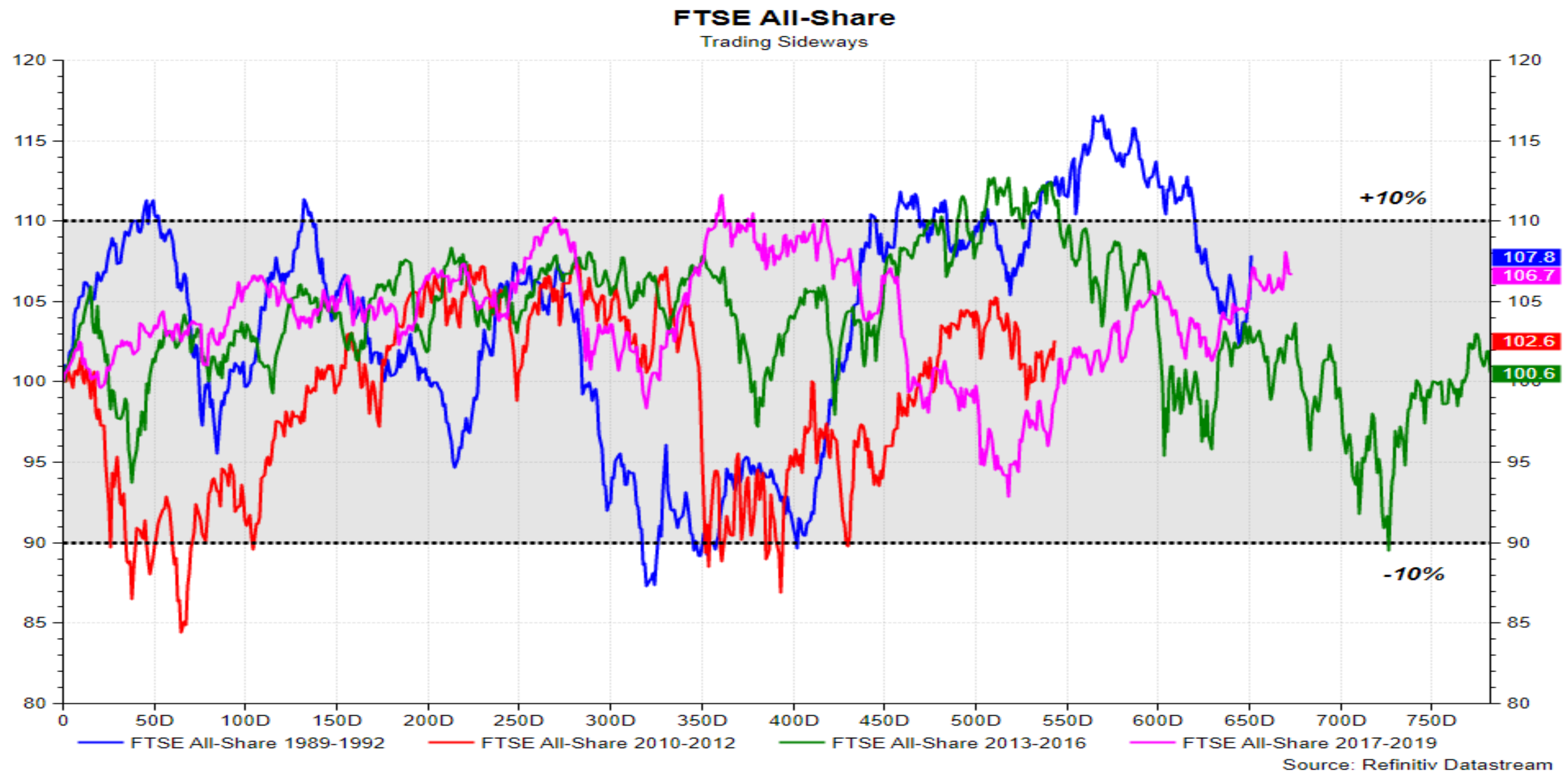
Where You Start Investing Matters.....Part Two!

Starting at the wrong point through poor judgement or just bad luck has long lasting implications; the four bear markets in recent history would have seen investors lose between 35%-50% with a recovery just to parity taking anything from 500 to 1800 days.



Accepting Prolonged Periods of Nothing!

There will be periods where not much happens – below are four periods where the FTSE-All Share returned very little over 18-24 months. These can be some of the most frustrating periods of all for investors where they frequently "throw in the towel".



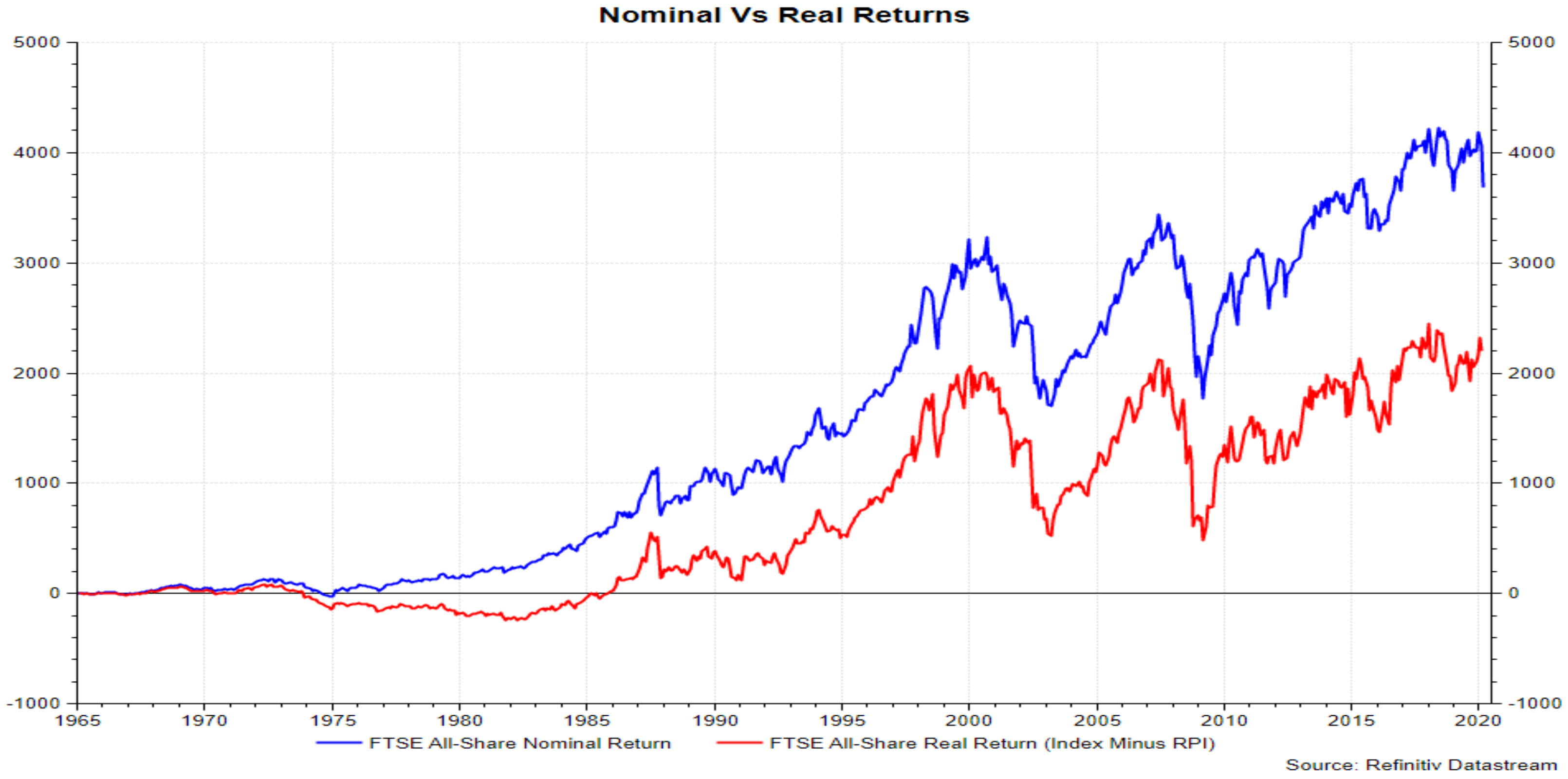
Avoiding Large Losses Is Crucial To Long Term Success

The impact of losses on portfolios and plans is significant; lose big and you need to be prepared to stay invested for a long time just to get your money back. Markets on occasions have, and will in the future, lose up to 50%; to get back to parity you would require a return of 7.18% per annum for 10 years. The annualised return from the FTSE-All Share Index since 1962 is 6.15%

	Value After Loss	Required Return To Get Back To £10,000	Required Annualised Return To Get Back to £10,000 in 3 Years	Required Annualised Return To Get Back to £10,000 in 5 Years	Required Annualised Return To Get Back to £10,000 in 10Years
Decline of 10%	£ 9,000	11.11%	3.57%	2.1%	1.06%
Decline of 20%	£ 8,000	25.00%	7.72%	4.6%	2.26%
Decline of 30%	£ 7,000	42.86%	12.62%	7.4%	3.63%
Decline of 40%	£ 6,000	66.67%	18.56%	10.8%	5.24%
Decline of 50%	£ 5,000	100.00%	25.99%	14.9%	7.18%

Think of Real Returns Not Nominal Returns

The graph below shows the effect inflation has had on the returns from the FTSE-All Share Index. inflation has a huge impact on the returns that you receive and this applies to all asset classes even cash; if cash is returns 1.5% and inflation is 2% the "real" value of your capital is falling by 0.5% per annum. High inflation when assets have low returns increases losses.



So What Does This All Mean For Investors?

Before embarking on any type of investment journey it is crucial to understand what to expect and the risks that exist.

Thinking carefully about what your objectives are and what your investments needs to do to help you achieve these goals.

Remember the key points and questions listed across when thinking about risk & return.

- Returns are variable from different asset classes; it is impossible to pick the best and worst year in year out. A diversified portfolio over a combination of asset classes can provide protection.
- Different asset classes have different return ranges; the median provides a good indication of what to expect over the long term.
- Assets with wide return range offer the opportunity to win big or lose big; how much variance in returns can you tolerate?
- Where you start investing matters a lot! It is important to have an understanding of where assets classes are valued in relation to their history. Ensure the potential rewards exceed the risk.
- Accept that sometimes not much happens and markets trade in a range making little or no progress – long term investors need to be able to tolerate a prolonged period of.........nothing!
- Large capital losses can be devastating and take a long time to recoup – inflict some pain on yourself and see what the effect of different types of decline could have on your objectives.
- Inflation eats away at returns turning even cash into an asset that can lose money – real returns matter more than nominal returns.
- Successful investing should be boring and uneventful, the best way to mitigate risk is not to take it in the first place.