Principles for successful long-term investing

Using Market Insights to achieve better outcomes

2Q 2017
MARKET INSIGHTS WAS FOUNDED IN 2004 IN THE WAKE OF THE FALLOUT FROM THE TECH BUBBLE. AT A TIME WHEN INVESTORS NEEDED IT MOST, THE FIRST GUIDE TO THE MARKETS PROVIDED CLARITY AND PERSPECTIVE, AND HELPED TO REINFORCE KEY HABITS OF SUCCESSFUL LONG-TERM INVESTORS. TODAY, MORE THAN A DECADE LATER, IT IS IN THAT SAME SPIRIT THAT WE ARE PLEASED TO OFFER, “PRINCIPLES FOR SUCCESSFUL LONG-TERM INVESTING”.

WE BELIEVE THAT A COMBINATION OF THESE PRINCIPLES, SOUND FINANCIAL ADVICE AND DEEPER INSIGHTS CAN HELP MAKE EVERY INVESTOR BETTER OFF.
PRINCIPLES FOR SUCCESSFUL LONG-TERM INVESTING

1. PLAN ON LIVING A LONG TIME.
2. CASH ISN’T ALWAYS KING.
3. HARNESS THE POWER OF DIVIDENDS AND COMPOUNDING.
4. AVOID EMOTIONAL BIASES BY STICKING TO A PLAN; AND STAYING INVESTED MATTERS.
5. VOLATILITY IS NORMAL; DON’T LET IT DERAIL YOU.
6. DIVERSIFICATION WORKS.
**LEFT:** We are living longer

Thanks to advancements in medicine, people are living longer, healthier lives. This chart shows how across Asia, the aging population is expected to increase significantly over time.

**RIGHT:** The benefits of saving and investing early

It is important for investors to start saving and investing early in order to maximize the benefits of compounding. This chart illustrates three scenarios where an investor starts saving at different times or choosing to invest in cash only instead of a mixture of financial assets. Those who start early and invest in a well-balanced portfolio should be better prepared for retirement than those who start late or invest only in cash.
Cash pays less

Investors often think of cash as a safe haven. Many investors will shy away from the stock market, unwilling to take on the added risk and afraid of possible losses. Since the 2008-09 Global Financial Crisis, investors have been living with near-zero interest rates. Even as the U.S. Federal Reserve is now only slowly normalizing policy, at a very gradual pace. Most other countries are still looking to maintain a low interest rate policy.

This ongoing era of ultra-low interest rates has depressed the yields offered on interest-bearing cash accounts to near-zero or even below zero to negative, in the case of some countries.
The power of dividends and compounding

Harnessing the power of compounding can greatly impact the amount of returns an investor makes. Looking at our analysis of the returns an investor gets from investing an initial $100 into the MSCI World Index, we can see that this would have grown to over $1,600 today if we merely look at the price returns.

The compounding effect will greatly increase returns if dividends are reinvested over time, the top grey line shows how if you included the dividend payments, assuming they were reinvested and allowed to compound within the account, the $100 would have grown to more than $6,000 today.
Avoid emotional biases

An important issue almost all investors face is letting human emotion and bias rule their investment decisions. Looking at historical net flows of mutual funds into the U.S. market, we can see that money flows into the market when prices were near peaks, and outflows when prices were near troughs. These flows tend to happen after the peak or trough occurs, thanks to badly-timed and often emotionally-driven investment decisions.

Stay invested

Thanks to the rash decisions mentioned previously, the average investor stands to possibly lose significant potential returns the longer they are out of the market. Our analysis shows that while the actual loss from missing a number of top returning days may be small, the implied compounding loss from not being in the market can become quite significant.
Good things come to those who wait

While markets can always have a bad day, week, month or even a bad year, history suggests investors are less likely to suffer losses over longer periods.

This chart illustrates the concept. While one-year stock returns have varied widely since 1950 (+47% to -39%), a blend of stocks and bonds has not suffered a negative return over any five-year rolling period in the past 65 years.
Volatility is normal

Investors should keep in mind that volatility is normal, significant drawdowns are part of the nature of equity investing and occur in most years. We can see the red dots represent the maximum intra-year decline in every calendar year going back to 1988. Though impossible to predict, every year has its rough patches.

The bars represent the full-year market index returns. Despite lots of bumps along the way represented by the red dots and an average intra-year drop of 18%, the market has delivered a positive return the majority of the time, in 17 out of 28 calendar years. For disciplined investors, market volatility and downturns can represent an opportunity to acquire more shares at a better price, provided, of course, they are willing to take a long-term view that markets will grow over time.
Diversification works

The last ten years have been a volatile and tumultuous ride for investors, with multiple natural disasters, numerous geo-political conflicts, and major market downturns. While volatility might be normal, investors can help minimize some of these risks through diversification.

Looking at the performance of various asset classes over the said period, despite the difficulties faced by markets, cash was still one of the worst performers. Meanwhile, a well-diversified portfolio, including stocks, bonds and some uncorrelated asset classes, provided a respectable annualized return of 5.7% per year with modest annualized volatility of 12.1%.

Markets can be volatile and even negative in any given day, week, month or year. But history shows that both time and a little diversification can go a long way towards more stable returns.
The Market Insights program provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the program explores the implications of current economic data and changing market conditions.

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