

Managing allocations in volatile markets



In 2002, the technology bubble burst. 2008 was a credit crisis and 2012 a sovereign debt crisis. This year, the coronavirus pandemic and oil price collapse have taken the world by surprise, likely leading to an unprecedented hit to global growth.

Triggers of bear markets can come in many shapes and forms, but our experience through these past crises has been similar – painful. While it is probably premature to call the end of this current bear market, we highlight some history lessons that investors can reflect on when managing an investment allocation during crisis times (regardless of what triggers it).

LESSON 1

REMEMBER THAT INVESTMENT TIMEFRAME MATTERS, AND BEAR MARKETS TEND TO BE SHARP BUT SHORT-LIVED

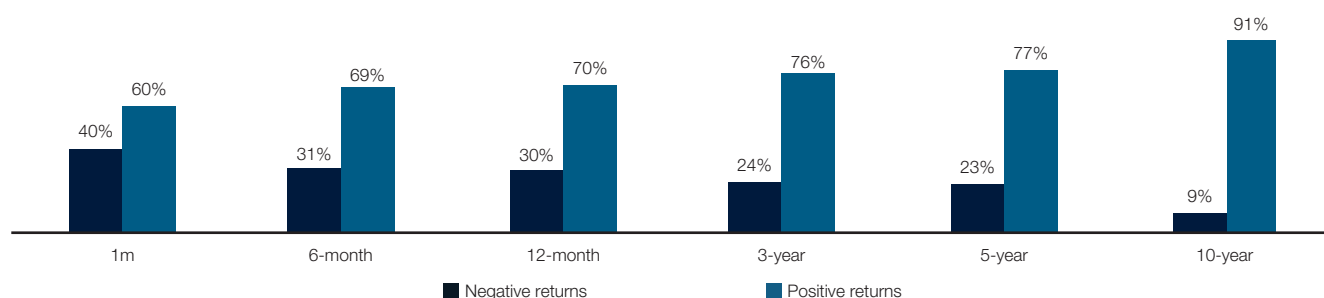
A historical analysis of global equity market returns (Figure 1 and Figure 2) shows that:

- Probabilities of suffering a drawdown of similar magnitude to that seen year to date (-33.8%) is low, although there is a lot more variability in returns within a given year than calendar-year results would suggest
- As investors extend their investment time horizon from short term (1-6 months) to longer term (5-10 years), the probability of enduring negative returns drops substantially (40% to 6%)

Bear markets tend to be short-lived, but also associated with extreme price action and pullbacks. However, 32 years of data show that as the global economy recovers from the shocks that triggered the recession, the probability of earning positive returns for long term investors is relatively high.

Fig. 1 Probabilities of return drawdown drop significantly as we extend the investment time horizon

Distribution of 1-month, 6-month, 12-month, 3-year, 5-year and 10-year returns of MSCI ACWI (data from 1988 to 2020)



Source: Bloomberg, Standard Chartered

LESSON 2

KEEP IN MIND THAT STAYING INVESTED THROUGH VOLATILE TIMES PROVES BENEFICIAL (IN ACHIEVING LONG-TERM INVESTMENT GOALS)

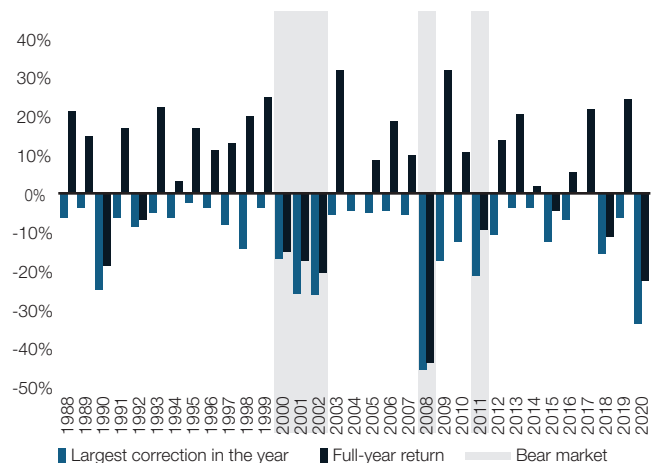
According to Nobel prize-winning Daniel Kahneman's "Prospect theory", for most of us, the pain of losses is twice the joy of a gain. The pain we feel this year due to global equities 33.8% peak-to-trough decline significantly outweighs the joy we might have had when markets posted strong gains in 2019. This very human trait tends to affect our decision-making process.

It is a natural inclination to want to get out of the market when things are ugly and get back in when things are better, but timing the market is more often than not a losing game. Although it is never easy to endure losses, it is important for us as investors to be patient. In Figure 2, the light blue bars represent the largest declines from a "peak" (high) to a "trough" (low) that occurred within each year, while the dark blue bars represent the corresponding return for the full calendar year. Despite significant intra-year volatility, the global equity index had positive annual returns in 20 out of the last 31 years since 1988.

While we cannot rule out further downside going forward as the impact from the shocks (COVID-19 and oil price collapse) continue to be assessed and priced by the markets, history shows that staying invested and riding through bear markets proves beneficial to achieving long-term investment goals.

Fig. 2 Despite intra-year volatility, the global equities had positive year-end total returns 20 out of the last 31 years since 1988 (to FY 2019)

MSCI ACWI largest declines vs. full year return (1988 – 2020)



Source: Bloomberg, Standard Chartered

LESSON 3

DIVERSIFICATION IS PARAMOUNT DURING TOUGH TIMES

Figure 3 compares performance statistics of 2 multi-asset allocations vs. various assets, showcasing significant benefits of staying diversified during market downturns. Put differently, diversification provides us as investors with more “staying power” (better risk tolerance) and downside protection to absorb our emotions during distressed times.

LESSON 4

UNDERSTAND THAT DE-RISKING WHEN MARKET UNCERTAINTY IS ELEVATED COMES WITH A COST AND YOU SHOULD NOT COMPROMISE YOUR DIVERSIFICATION

If you feel your portfolio is not aligned with your long-term objectives, or have a more bearish view of the future, then you might want to (i) reduce exposure to risky assets or (ii) incrementally add adequate protection. One approach worth considering is to take advantage of any short-term rebound in risk assets to rebalance to our suggested recession allocation (which is proxied by 15% Cash, 10% Gold, 60% Global Bonds, 5% Alternatives, 10% Global Equity). This allocation saw a drawdown of just 4% in the recent sell-off.

That said, de-risking is not free of risks. First, rotating to safe-haven assets implies increasing the investor's exposure to the risk that yields rise sharply from here. Second, there are embedded opportunity costs of missing out gains from potential rebounds in risk assets, such as equity and high yield bonds. To highlight this point, Figure 3 shows average returns across assets 12 months post the trough in bear markets, which tend to be strongly positive.

LESSON 5

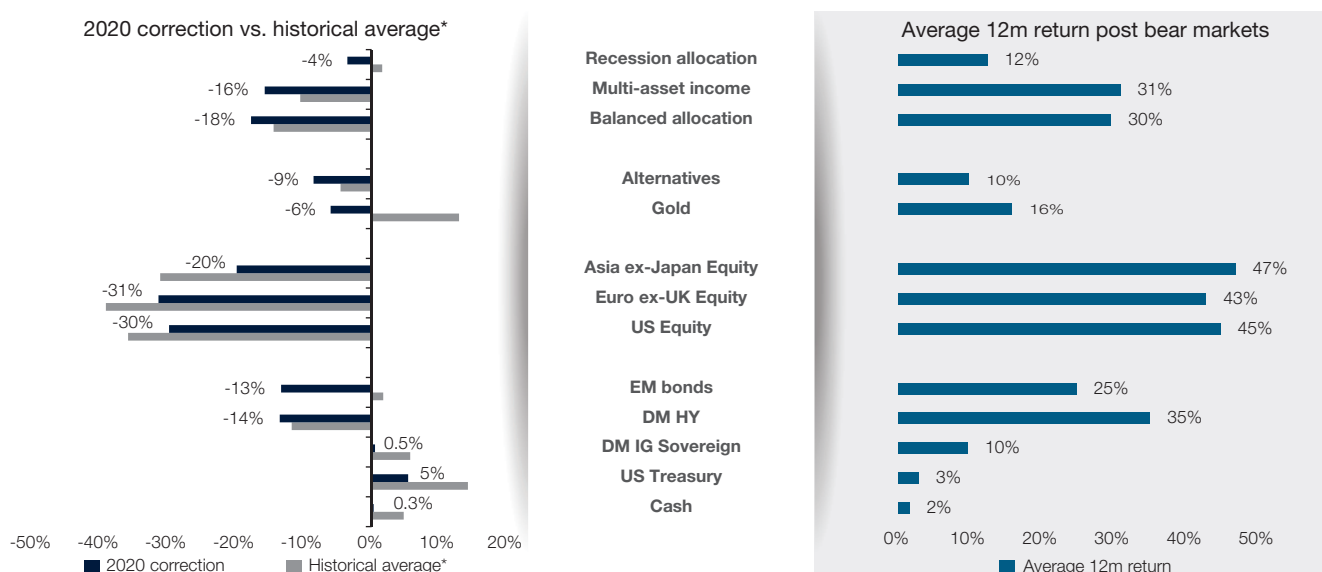
BE READY FOR THE ROAD TO RECOVERY

Against the backdrop of current market conditions, our base case is that the probability of a global recession induced by the growth shock remains high; adverse developments on COVID-19 and containment measurements can keep market volatility high in the short term.

However, with global equities down 22% year-to-date, instead of risking an error of selling near the bottom, we would focus on (i) ensuring you can hold the portfolio through any further short-term correction and (ii) starting to look for attractive long-term opportunities to deploy further capital. Specifically, we like global equities, Asia ex-Japan equities, US equities, Asia USD bonds, EM USD bonds and Gold. In all cases, a diversified balanced allocation can constitute both a useful tool and a prudent approach to get ready for the recovery journey ahead.

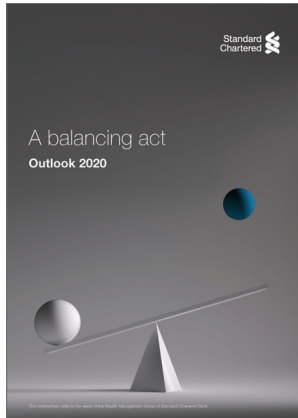
Fig. 3 Diversified allocations perform well post bear markets

Performance of various assets during 2020 correction vs. historical averages during and post bear markets



Source: Bloomberg, Standard Chartered. *Bear markets used in this study are the ones that took place in 2002, 2008, 2011, and 2018. Global multi-asset allocation is proxied by 7%DM IG gov't, 8% DM IG corporate, 20% DM HY, 20% EM debt, 30% Global HDY equities, 5% Covered calls Global balanced allocation is proxied by 15% Global bonds, 20% EM debt, 45% Global equities, 5% Gold, 5% Alternatives.

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