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InvesTips

Managing
allocations in
volatile markets

June 2022



WS Global CIO Office



In 2002, the technology bubble burst. 2008 was a credit crisis and 2012 a sovereign debt crisis. In 2020, the COVID-19 pandemic and oil price collapse took the world by surprise and led to an unprecedented hit to global growth.

In the first half of 2022, markets have been very challenging against the backdrop of high interest rates, stubborn inflationary pressures, soaring commodity prices and prolonged geopolitical risks.

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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 never easy to time the market cycle, we highlight some history lessons that investors can reflect on while managing an investment allocation during times of crisis (regardless of what triggered).

Lesson

1

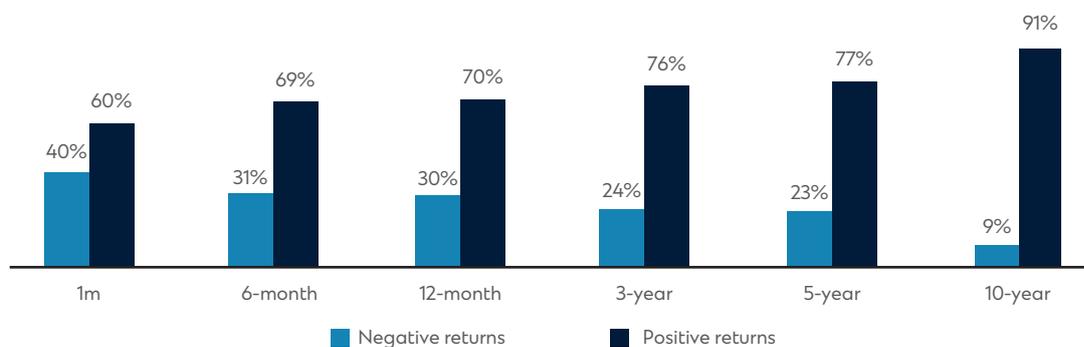
Remember that investment timeframe matters, and bear markets tend to be sharp but short-lived

A historical analysis of global equity market returns (the chart below and that on Page 4) shows that:

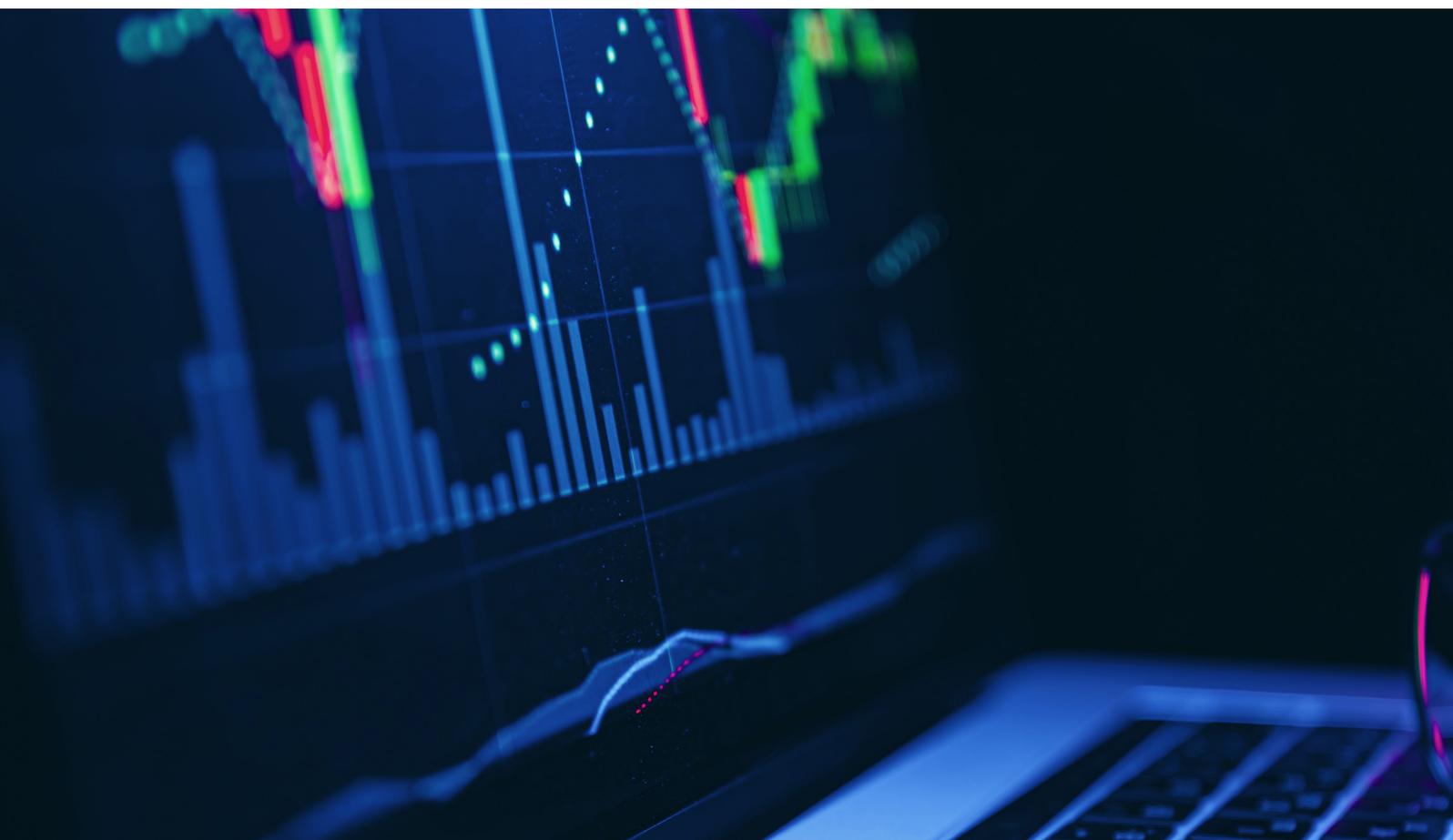
- Probabilities of suffering a drawdown of similar magnitude to that seen in 2020 (-33.8%) is low, although there is a lot more variability in returns within a given year than calendar-year results would seem to suggest.
- As investors extend their investment time horizon from short term (1-6 months) to longer term (5-10 years), the probability of enduring negative returns drops substantially (40% to 9%). 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 are relatively high.

Probabilities of return drawdown drop significantly as we extend investment time frame

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)

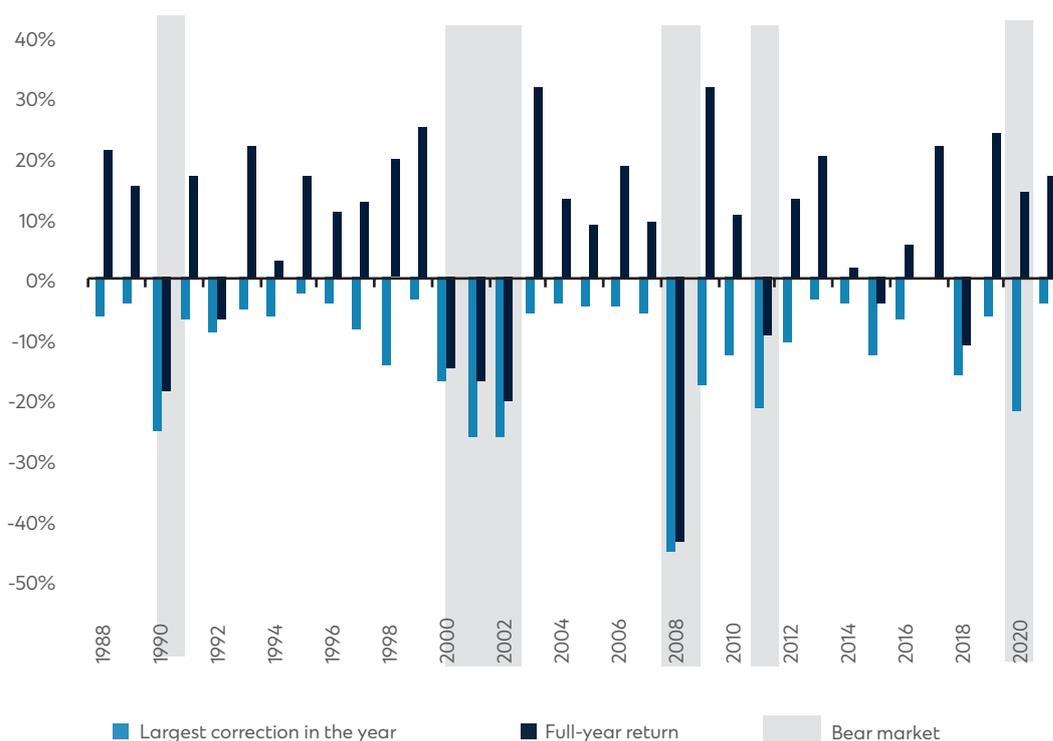
According to Nobel prize-winning Daniel Kahneman’s “Prospect theory”, for most of us, the pain we feel from losses is twice as great as the joy we get from financial gain. The pain we have felt in 2020 due to global equities 33.8% year-to-date decline significantly outweighs the joy we might have had when markets posted similar size 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 chart below, 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 23 out of the last 34 years since 1988.

While downside risk is always an investor’s concerns, history shows that staying invested and riding through bear markets proves beneficial to achieving long-term investment goals.

Despite intra-year volatility, the MSCI ACWI had positive year-end total returns 23 out of the last 34 years since 1988

MSCI ACWI largest declines vs. full year return (1988 – 2021)



Source: Bloomberg, Standard Chartered.

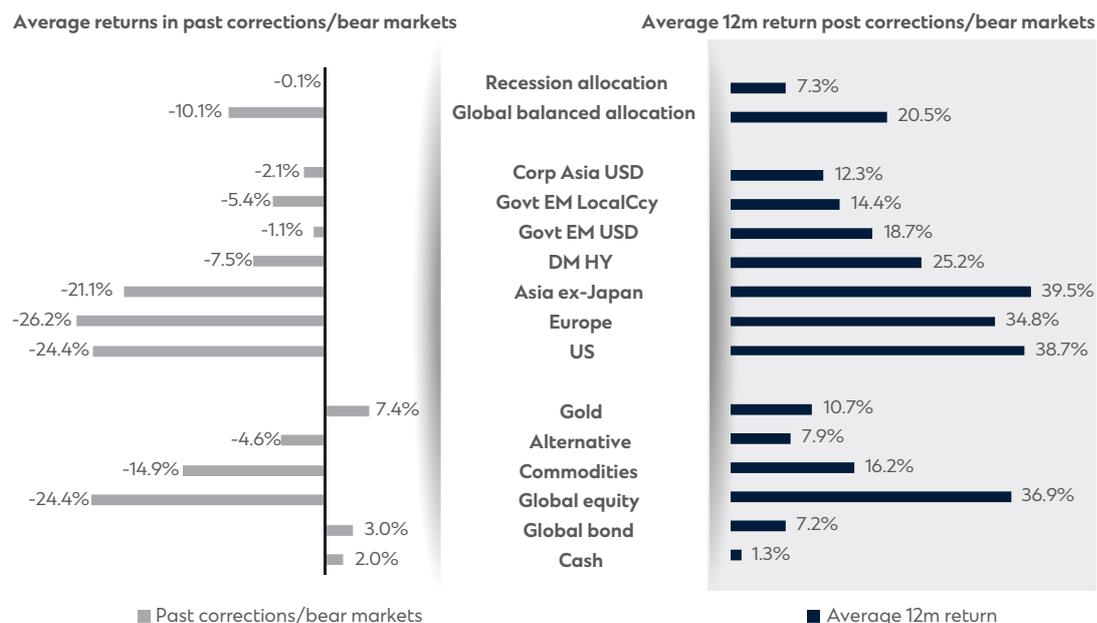
Lesson # 3

Diversification is paramount during tough times

The chart below compares performance statistics of a multi-asset allocation 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.

Diversified allocations perform well post periods of major market downturns

Average performance of various assets during vs. post market corrections and bear markets since 2000*



Source: Bloomberg, Standard Chartered. *Periods in scope include all corrections that are declines of 10% or more. And bear markets that are declines of 20% or more. Global balanced allocation is proxied by 5% Cash, 35% Global bonds, 45% Global Equity, 5% Gold, 10% Alternatives. Recession allocation is proxied by 15% Cash, 60% Global bonds, 10% Global Equity, 10% Gold, 5% Alternatives.

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 has proved to be resilient through most major market corrections and bear markets since 2000 (refer to the chart above).

That said, de-risking is not free of risks. First, rotating to safe-haven assets implies increasing the investor’s exposure to risks 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, the chart above shows average returns across assets 12 months post the trough in major corrections and bear markets, which tend to be strongly positive.

Lesson # 5

A diversified allocation for the long and winding road ahead

As we progress further in this economic cycle, the shift toward a regime of high interest rate, high inflationary pressure, and high commodities prices has been and should remain a source of market volatility going forward.

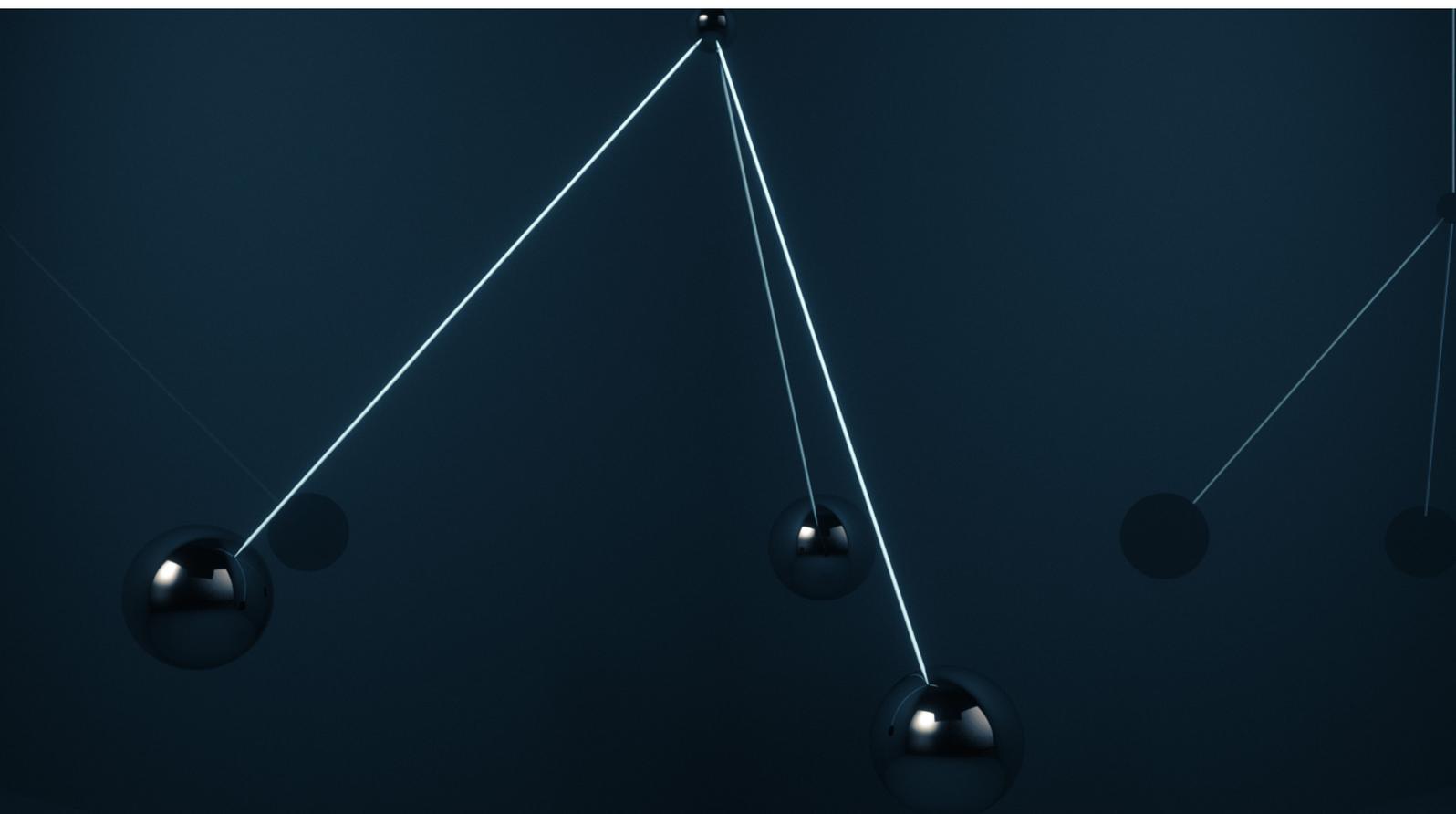
Against this backdrop, we would suggest investors focus on (i) improving portfolios' resilience to hold through any short-term market fluctuations and (ii) starting to look for attractive long-term opportunities to deploy further capital. In all cases, a diversified balanced allocation can constitute both a useful tool and a prudent approach for a successful journey to achieve long-term investment goals. To demonstrate this point, we looked at hypothetical scenarios in which investors start investing at the equity market peaks prior to major drawdowns (including bear markets) and remain invested in the subsequent 3 years. Looking at performances of different investments in such scenarios, we note that, on average, a global balanced allocation shows more superior risk-adjusted return (similar return with lower risk) compared to most asset classes (refer to the table below).

A well-diversified allocation shows more superior performances over the long term

Average of annualized returns and volatilities of various assets and a global balanced allocation 3 years after invested at the equity market peaks prior to major drawdowns since 2000

	Global bonds	Global equity	Alternatives	Gold	Global balanced allocation*
Average volatility (ann.)	5.3%	15.6%	4.9%	16.2%	8.4%
Average return (ann.)	4.9%	5.5%	2.2%	6.6%	4.8%
Risk-adjusted return	0.93	0.35	0.45	0.41	0.58

Source: Bloomberg, Standard Chartered. *Global balanced allocation is proxied by 5% Cash, 35% Global bonds, 45% Global Equity, 5% Gold, 10% Alternatives.



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