

INSIGHT

THE GREATEST WEALTH IS **YOUR PEACE OF MIND...**



BARNETT
RAVENSCROFT
WEALTH MANAGEMENT

Plan for the worst, hope for the best



Plan for the worst, hope for the best

Diversification is a feature of portfolios that brings with it both pain and pleasure. The former is often in the form of FOMO (the ‘fear of missing out’ on what has recently performed well) and the latter as the satisfaction of enjoying a smoothed investment journey. Unfortunately, humans are poorly wired to be investors, and the emotional pain often dominates the (much subtler) pleasure. In the extreme, this can lead investors to make short term – generally detrimental – changes to their portfolios. Building a robust investment portfolio and sticking with it requires fortitude and confidence in the evidence that underpins it.

“The investor’s chief problem – and even his worst enemy – is likely to be himself”

Benjamin Graham

We structure your portfolio with a long-term view in mind. We accept that the relationship between risk and return usually holds true. We also accept that markets are hard to beat, and that most investors aiming to pick tomorrow’s winners fail to do so. We are guided by the evidence to put in place a solution that strikes a balance between the expected upside whilst limiting the expected downside. The future returns of markets, performance of economies and release of new information are all phenomena outside of our (and anyone else’s) control, though with sensible diversification we can mitigate the impacts of unanticipated downturns.

Diversification features comprehensively throughout your portfolio. Your portfolio benefits from the exposure to thousands of stocks, across tens of countries and a wide array of sectors. We also ‘tilt’ to smaller and value (cheaper) companies. Decades of evidence supports the view that a sensible exposure to these ‘risk factors’ rewards investors in the form of higher returns. An incidental – and positive – result is a further increase in diversification.

As well as looking at the potential upside of investment decisions, it is important to consider the impact on the possible downside. One key element of financial planning is modelling fire drill scenarios. The figure below considers the worst historic periods for a 60% equity, 40% bond portfolio. The figures are presented after inflation, thus showing the real impact on an investor’s purchasing power. It is clear that there is a significantly positive impact of tilting the portfolio to smaller and value companies.

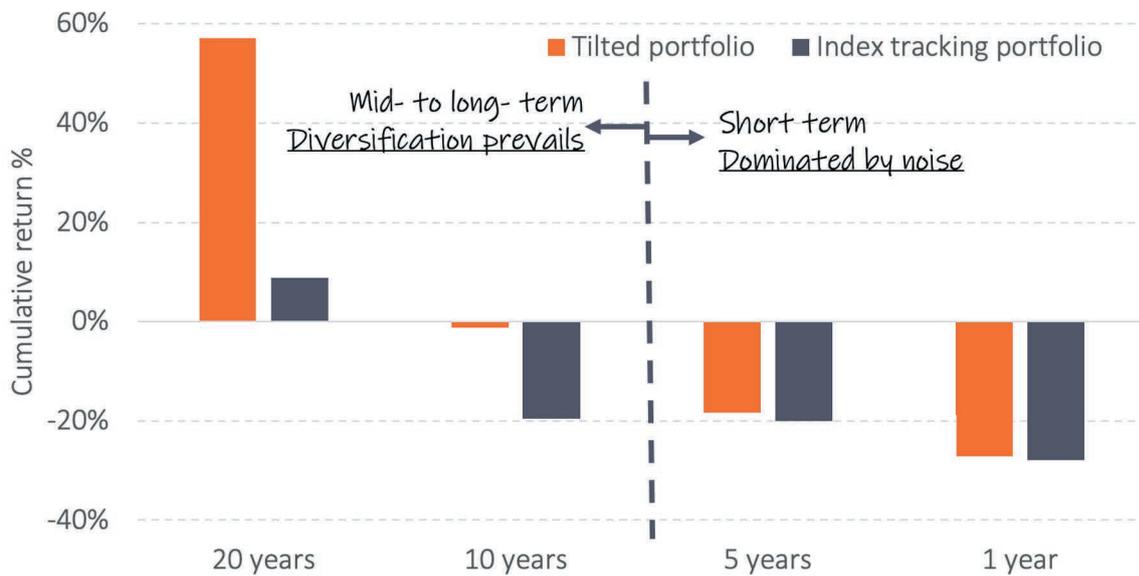


Figure 1: Worst outcome in real terms - tilted vs index tracking 60/40 portfolio Nov-27 to Oct-21

Data source: Morningstar Direct © All rights reserved. See footnote for further details.¹

Shorter term outcomes are dominated by noise. The benefits of a well-structured portfolio and diligent approach become clearer with time. History has shown us that even the worst 10 and 20-year outcomes of a sensibly tilted portfolio provide considerable protection of purchasing power, and we hope markets will be kinder than this going forward, delivering much more positive returns. You can take quiet comfort in the fact that your investments are in a sensible, and deeply considered, space. Stick it out through the pain, whenever that may come, and as a result of the diligence you will be able enjoy the pleasure.

End notes

1.
Returns presented in cumulative terms in USD adjusted for IA SBBI US Inflation. Annually rebalanced. No costs deducted. Tilted portfolio is 36% broad market, 12 % value, 12% small cap, 40% fixed income. Index tracking portfolio is 60% broad market, 40% fixed income. Broad market: IA SBBI US Large Stock TR USD Ext, MSCI World from Nov-71; value: Fama/French US Value Research Index, Dimensional Global Large Value from Nov-76; small cap: Fama/French US Small Cap Research Index, Dimensional Global Small Cap from Nov-71; fixed income: IA SBBI US IT Govt TR USD, FTSE WGBI 1-5 Hdg USD from Nov-86.

Other notes and risk warnings

Use of Morningstar Direct® data

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