When emotions gain the upper hand

Commentary on the long-term performance of equities and bonds

Rainer Gänsslen | Pictet Wealth Management | January 2019

Are things really getting worse?

So that was 2018: restrictions on international trade, geopolitical tensions, the rise of right-wing populism, Brexit, the phasing out of monetary easing, climbing inflation, fears of a recession, and so on – it would be easy to add to this list. Yet even the positive effects of the previous year's corporate tax reform in the USA could not prevent almost all relevant asset classes making a loss last year (see Perspectives, Special Edition January 2019; link below[1]).

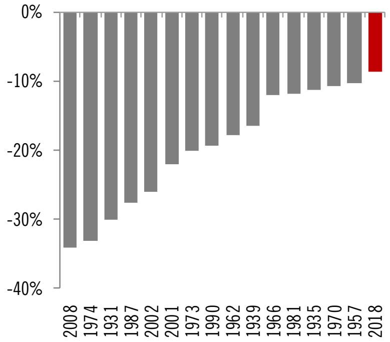
It's hardly surprising that investors feel as though 2018 was the worst year for a long time. But emotions are funny things when it comes to finances, because the impression that equities have not had such a bad year for ages is quite simply wrong.

It's true that 2018 was not a great year for the Swiss financial market: according to our study, the equity market lost 8.6% and bonds only just managed to turn in a positive performance of 0.2%. Yet the Swiss equity market has experienced considerably worse years: our study now covers a period of 93 years (1926-2018), and 2018 in fact ranks only 16th on the list of worst equity market performances. In the 15 years that were even worse, the equity market corrected between 10% and 34% (see Figure 1). Admittedly, in those years the bond market usually made up for rather more of the losses than was the case in 2018.

There are other years that rank high on the negative hit list: 2008, the year of the financial crisis, comes top with a loss of 34%. And the Swiss equity market also posted losses of between roughly 20% and 27% in 2001, 2000, 1990 and 1987.

So there's no need for panic – just for caution. The current economic cycle is one of the longest (although also one of the weakest) in history. Investors should therefore be ready for corrections and take appropriate care when investing.

Fig. 1: The years with the biggest losses on the Swiss equity market



Source: Banque Pictet & Cie SA

Even if investors exit the equity market, or at least reduce their equity allocation, they need to ask themselves when it will be the right moment to dive back in or increase their equity allocation. This is by no means an easy decision to make.

On a long-term view, the results for 2018 do not warrant a reassessment of the overall picture. What we said in our commentary on the results for 2017 continues to apply: the results of

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[1] https://perspectives.pictet.com/wp-content/uploads/2019/01/EN_Perspective-Janvier-2019-Special-Edition.pdf

our long-term analysis clearly show that long-term investors with sufficient risk tolerance should keep a high proportion of tangible assets in their portfolios. Whereas there have been a number of 5-year investment periods in which the Swiss equity market posted losses, there have been considerably fewer 10-year periods. And there has not been a single 15-year investment period over which equities turned in losses. The Pictet yield triangle illustrates this strikingly (see Figure 2; see also the remarks below on the same topic). Here we are talking about an investment in equities only, with no diversification into bonds or other asset classes.

Over the long term, equities are the investment of choice

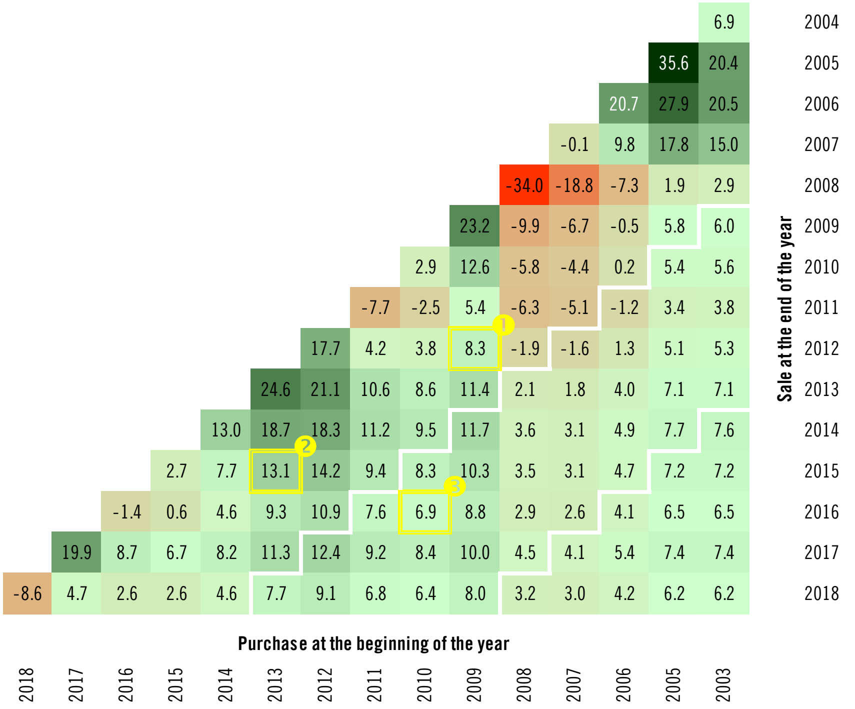
The historical data speak for themselves: over investment periods of more than 13 years, investments in Swiss equities have never posted a negative return.

We have prepared a visualisation in the form of a yield triangle; this can be downloaded from our website (http://group.pictet/longterm-study).

Figure 2 is an extract from the Pictet yield triangle. The chart shows the annualised performance for each investment period from the beginning of 2004 to the end of 2018.

The white diagonals separate 5- and 10-year investment periods.

Figure 2: Extract from the Pictet yield triangle



														6.9	2004
													35.6	20.4	2005
												20.7	27.9	20.5	2006
											-0.1	9.8	17.8	15.0	2007
										-34.0	-18.8	-7.3	1.9	2.9	2008
									23.2	-9.9	-6.7	-0.5	5.8	6.0	2009
								2.9	12.6	-5.8	-4.4	0.2	5.4	5.6	2010
							-7.7	-2.5	5.4	-6.3	-5.1	-1.2	3.4	3.8	2011
						17.7	4.2	3.8	8.3	-1.9	-1.6	1.3	5.1	5.3	2012
					24.6	21.1	10.6	8.6	11.4	2.1	1.8	4.0	7.1	7.1	2013
				13.0	18.7	18.3	11.2	9.5	11.7	3.6	3.1	4.9	7.7	7.6	2014
			2.7	7.7	13.1	14.2	9.4	8.3	10.3	3.5	3.1	4.7	7.2	7.2	2015
		-1.4	0.6	4.6	9.3	10.9	7.6	6.9	8.8	2.9	2.6	4.1	6.5	6.5	2016
	19.9	8.7	6.7	8.2	11.3	12.4	9.2	8.4	10.0	4.5	4.1	5.4	7.4	7.4	2017
-8.6	4.7	2.6	2.6	4.6	7.7	9.1	6.8	6.4	8.0	3.2	3.0	4.2	6.2	6.2	2018
2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2003	

Source: Banque Pictet & Cie SA; Pictet Wealth Management; http://group.pictet/longtermstudy

Examples:

Those who invested in the Swiss stock market at the beginning of 2009 were able to record an average annual performance of 8.3% in this four-year period at the end of 2012
(see ❶ in Figure 2). Similarly, we saw average performances of 13.1% (❷) and 6.9% (❸) for the years 2013–2015 and 2010–2016, respectively.

Our analysis of historical returns shows that over the last 93 years, no losses were incurred with equities for investment periods of more than 13 years.

Conclusions

2018 was indeed a disappointing year for most equity holders. One reason was that most of the losses on the equity market occurred in the fourth quarter, particularly in the last few days of December. It is probable that few investors expected this to happen.

Our experience of looking after sizeable and professional private investors and family offices over many years shows that the biggest risk for investors lies in drastically reducing the (supposed) portfolio risks during times of unsatisfactory capital market performance, contrary to their objective risk tolerance, and then missing the market upturn. Sitting out phases of significant losses admittedly requires a certain amount of (subjective) risk tolerance.

In this respect we now repeat the advice we have given in recent years: investors should devote considerable time and reflection to defining a long-term, robust and sustainable investment strategy, and to its implementation.

Only too often, this vitally important question takes second place to other questions that are only thought to be important (cost of asset management, cost of advice, cost of analysis and monitoring of asset managers).

In the period from the start of 1926 to the end of 2018, the average annual (annualised) growth in value of an investment in the Swiss equity market came to approximately 7.6%. Anyone who had invested CHF 1,000 in equities at the beginning of 1926 would, according to our study of the Swiss equity market, have turned the CHF 1,000 into CHF 940,000 by the end of 2018. If we assume an average cost rate of 0.5% per year, costs totalling approximately CHF 78,000 would have been incurred over the 93 years. The bottom line is that the investor would still have made some CHF 860,000.

Deciding to invest in the bond market rather than the equity market would have proved considerably more costly: the original CHF 1,000 would only have risen to about CHF 49,000 (before costs!) over the same period. The opportunity costs would therefore have amounted to at least CHF 800,000.

Good advice is expensive – but worth it!

Author

Rainer Gänsslen has been working at Pictet for more than 19 years as a family office expert. In this role he is responsible for giving conceptual and tactical advice to very wealthy private individuals and institutional investors regarding the entire investment process. His tasks include preparing strategic asset allocations, organising investments, constructing portfolios and overall investment monitoring. He also helps his clients set up customised investment solutions and structures. In addition, he coordinates, monitors and optimises the global investment activities of his clients. His clients include high-net-worth individuals, global family offices and institutional investors in Switzerland and abroad.

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