Investments beyond 2020

Adapt to changing times but keep your investment fundamentals the same.

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The investment world is changing. In the past ten to fifteen years, there have been three significant changes: interest rates have dropped; bond funding durations are increasing; and growth stocks are out-performing values stocks. These are now affecting returns for investors and the risk (or volatility) in these returns.

Interest rates have fallen to extremely low levels, even negative in several countries

You can see from this data, compiled from publicly available information, the 10-year government bond yields around the world now and 15 years ago.

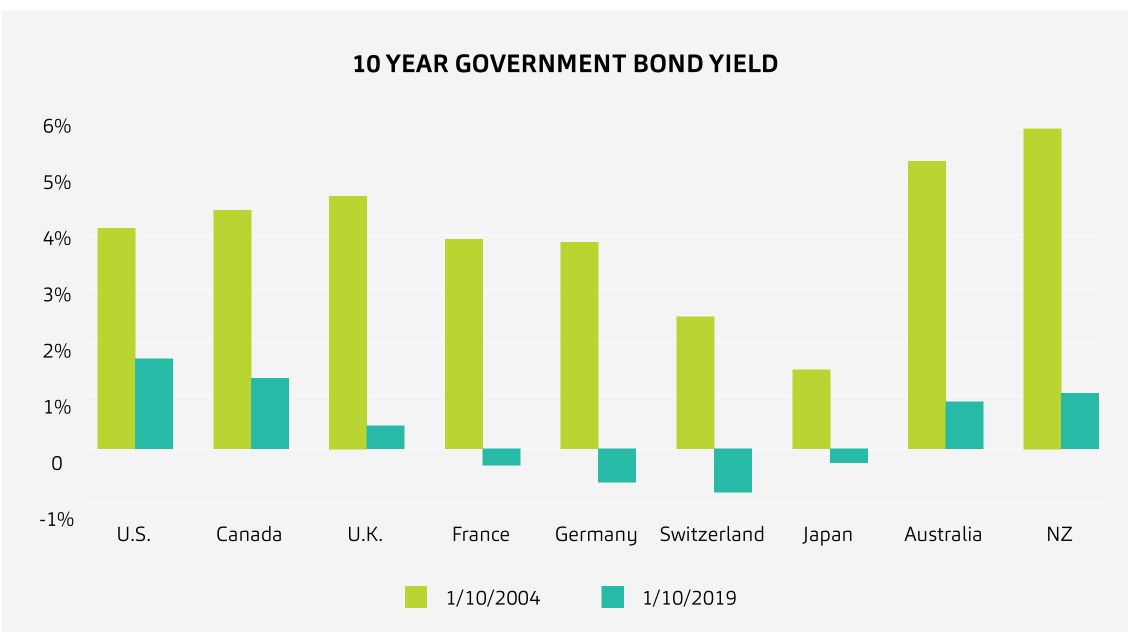
The return investors were getting from bonds or term deposits previously is nowhere near the low level they are now.

The Duration of Bond funds is increasing, thus increasing volatility

The Bloomberg Barclays U.S. Aggregate Index duration has increased from 4.5 years in 2004 to 6 years in 2019. Over the same period, the yield has fallen from 4.15% to 2.5% (Source Bloomberg Index Services Ltd as at 28/6/19). This means that not only are income yields going to be lower, but the volatility of the securities is likely to increase.

Value stocks have underperformed growth stocks for ten years now

In the last ten years (to Jun 2019), growth shares have outperformed value shares over almost every period. In total, 3.3% per annum better off (using MSCI index data[1]) with the distribution between the two at its widest



1 The MSCI World Index stands for Morgan Stanley Capital International (MSCI), and is an index used to measure equity market performance in global markets. SOURCE: Investopedia.com

now. This is contrary to numerous past studies (notably Fama and French and Warren Buffett) that suggest over the long-term the value approach outperforms growth.

These changes are now making investors think about alternative ways to invest their savings. For example, investors who require a regular income stream have previously achieved this from bank term deposits or direct fixed interest. They used to obtain a consistent income of around 5-8% per annum with a low level of risk. This level of return is now not available for that level of risk. Investors are having to either lower their regular income requirements or, more likely, look for alternative investments to achieve the desired level of income. This can be from high yielding stocks, like property or energy stocks in New Zealand, or higher-yielding riskier bonds globally.

Similarly, in this low-interest rate environment, equity investors are looking to invest in megatrends, such as aging populations; rapid urbanisation; or technological breakthroughs. These growth sources are unrelated to cyclical factors and interest rates.

When investors look to 2020, there are many ways to capture these changes. However, they must keep to the investment fundamentals:

Diversification

Diversification can help mitigate investment risk in your portfolio.

Asset allocation

Select the right mix of assets to meet your investment objectives.

Stick to your strategy

Particularly valid when markets are down. Stock prices fluctuate more than companies' fundamentals.

Time, not timing

It is more important to stay invested in the markets.

Review and rebalance

You should review your portfolio at least annually to make sure your asset allocation stays on track.

While some things change, the investment fundamentals remain the same.

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