The importance of remaining invested

Over the past 20 years, several major global events – including, most recently, the coronavirus pandemic – have prompted a fleeing of financial markets, but data shows this would have been a mistake.

In this article we consider how not being fully invested for just 10 of the best performing days over this period could have led to a portfolio's significant underperformance over the long term.

Financial markets have behaved in an extremely volatile manner since February and in such conditions, it is tempting to consider exiting these markets or switching to cash, with the intention of reducing further expected losses. While sharp declines can be disconcerting, it is crucial to understand that remaining invested over a long time frame, through the various 'ups and downs', tends to be the better option in achieving longer term investment goals.

Trying to 'time the market' is a strategy that carries with it the risk of missing out on some better periods of market performance, which is why 'time in the market' remains the time-tested better solution.

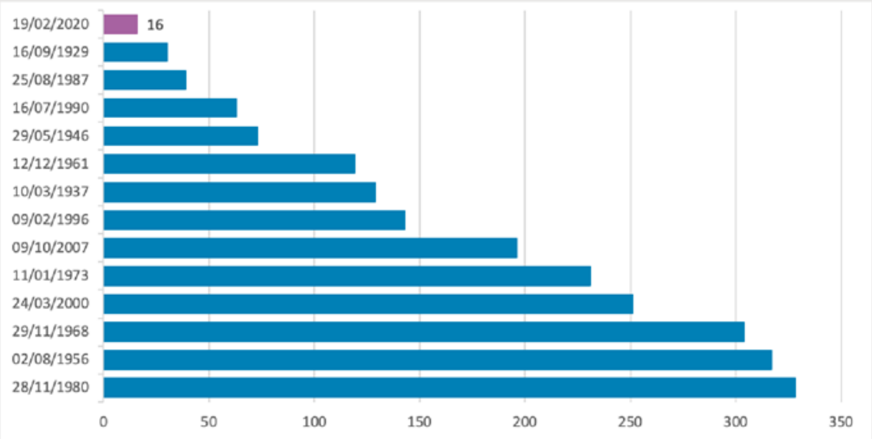
It is often said that when riding a really scary rollercoaster the only people who get hurt are those who jump off.

When volatility plays with your emotions, focus and remember why you invested in the first place.

In the current environment, it is understandable that many people are concerned about the impact of both the coronavirus outbreak and resulting mitigation measures, and how this is being reflected in the value of their investments.

To give some context, the speed at which the market entered into 'bear' territory (typically a 20% decline) in response to the Outbreak was the fastest in history, as this chart shows:

Number of trading sessions to fall at least 20%



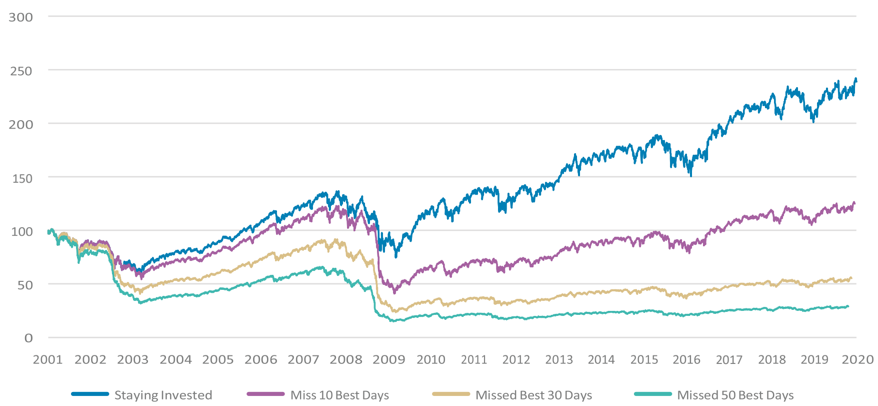
MSCIUSA,SourceBloomberg,datesasshown.Pleaseseeimportantinformation.

Despite temptations to switch into cash, data shows that missing out on just the 10 best performing days can have a big impact on long-term returns. This is illustrated in the following chart, using the example of the UK equity market over the past twenty years:

Staying ‘fully invested’ during the ups and downs has resulted in an initial £100,000 portfolio, for example, having an ending value of £240,000, compared to £125,000 for those that missed the 10 best days. This effect also highlights the powerful effect of ‘compounding returns’ over time.

If, for example, the 30 and 50 best days are missed, the long-term returns are indeed negative.

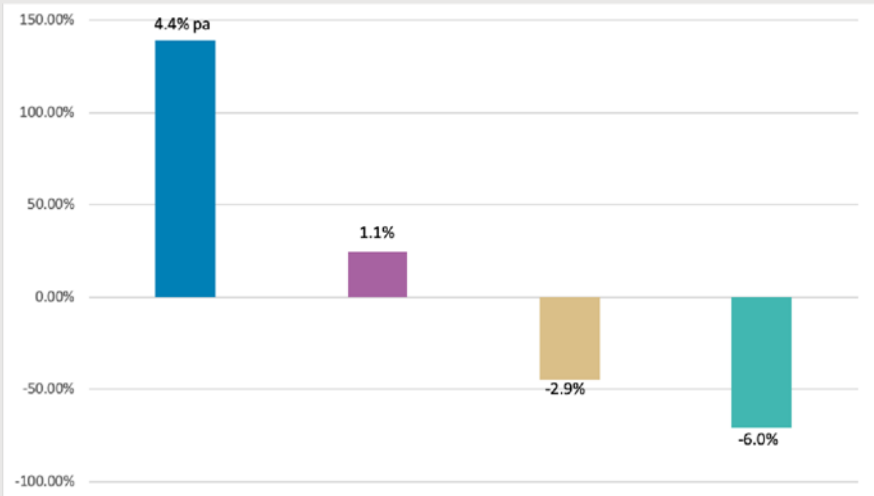
Timing the market



Source Bloomberg, MSCI UK TR, Dates 01/01/01 to 01/01/20. Rebased to 100 at 01/01/01

A different way of delivering the same message, where staying invested over the 20 year period generates annualised returns of 4.4% compared to 1.1% annualised returns if one misses the 10 best days.

Staying fully invested

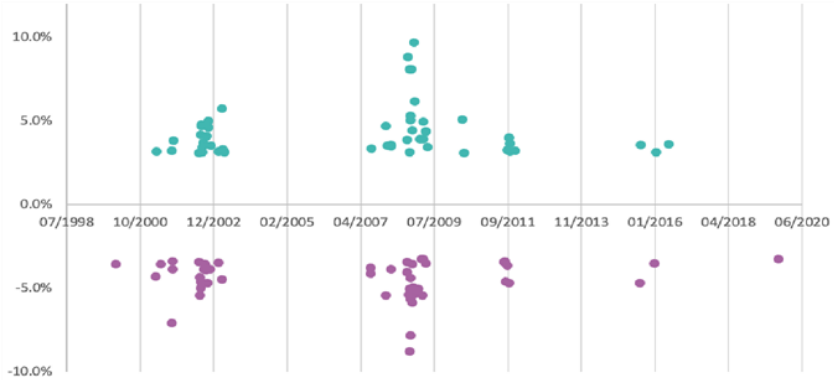


SourceBloomberg,MSCIUKTR,Dates01/01/01to01/01/20.Rebasedto100at01/01/01

‘Buy and hold’ may be an emotional rollercoaster during times of market stress, but research shows time and time again that this is the best investment approach over the long term. For example, one such study for UK retail investors shows that, on average, their investment timing decisions resulted in underperformance of 1.2% per year against a buy and hold strategy (Clare & Motson, 2010).

One argument may be that many investors just want to raise cash, sit tight and re-enter the market at some point in the future when markets have regained some composure. They may not be concerned about missing the best days, but just avoiding the worst days and months. However, the best and worst days are often clustered together:

Best and worst days tend to cluster (MSCI - please see important information)



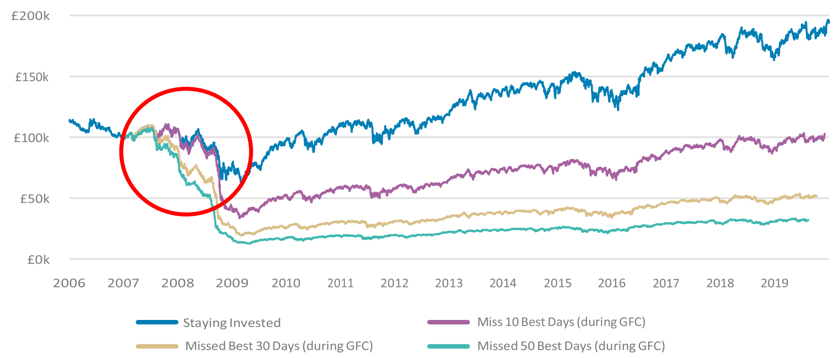
Source Bloomberg, MSCI UK TR, Dates 01/01/01 to 01/01/20

We can evidence this more recently where daily rallies have been among the top recorded in over 20,000 trading sessions. The moves in the US equity markets (on 24/03/2020) were the best since the end of October 2019. This is also true of European and UK equity markets, which had daily returns in the top five days on record (on 24/03/2020). Another academic study looked at US equity market returns over an 80-year period and found that 60%-80% of the best and worst days occurred in declining markets (Faber, 2011).

During the 2008 financial crisis, missing the best days during the downturn and subsequent upturn can again have a large impact on the returns generated over the subsequent 10-15 years.

"The moves in the US equity markets (on 24/03/2020) were the best since the end of October."

Cashing out during Global Financial Crisis 2007



Source Bloomberg, MSCI UK TR, Dates 01/01/06 to 01/01/20. Rebased to 100 at 01/01/2007

This message of the importance of staying invested is also supported by evidence of how markets behaved during previous virus scares. As shown in the chart on the right, selling out at each point the market had first knowledge of previous outbreaks (SARS, Zika, MERS, H1N1 Swine Flu) and re-entered the market 6-12 months later, this would have had a profound impact on long-term returns over the 20-year period shown.

Source Bloomberg, SCI AC World, D-MSCI - please see important information. Dates 01/01/01 to 01/01/20. SARS 10/02/2003, ZIKA 03/05/2015, MERS 20/09/2012, H1N1 03/03/2009. Rebased to 100 at 01/01/01

Once bear markets occur, they are relatively short in duration. Research shows the average time span of bear market drops is around eight months, with 75% of the declines recouped in seven months while, on average, a full rebound has come in just over one year.

With the benefit of hindsight, we are now fully aware of the global impact of COVID-19, and the rapidity in which it has hit equity markets. While markets have rivalled the speed of the virus in trying to price-in the near-term damage, we expect they could also be swift to act when a tipping-point is seen to be close-at-hand.

By Keeping to an established and proven investment framework, we can look to take advantage of short-term volatility as we continue to seek out longer-term investment opportunities.

The research, data, facts and figures discussed should aid you in avoiding behavioural biases that may result in short-term decisions that negatively impact long-term return potential. Yes, the journey may not be smooth, but long-term returns achieved support the case for looking through the noise, avoiding the social media newsfeed, and remaining invested during times of market stress.

IMPORTANT INFORMATION

Investors should be aware that the price of investments and the income from them can go down as well as up and that neither is guaranteed. Past performance is not a reliable indicator of future results. Investors may not get back the amount invested. Changes in rates of exchange may have an adverse effect on the value, price or income of an investment. Investors should be aware of the additional risks associated with funds investing in emerging or developing markets.

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