Global Investment Strategy

Global Investment Strategy Report

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Weekly market insights from the Global Investment Strategy team

- *Despite a Brexit-induced sell-off in risk assets, diversified portfolios remain in positive territory year-to-date.*
- *While investors are appropriately cautious, near-term events, fair-to-stretched valuations and low growth expectations are not sufficient reasons to avoid investing for the longer term.*

What it may mean for investors

- *Many investors are putting away money today to be used in the years and decades to come. The asset allocation of a portfolio should correspond to the time frame of the investor's goals.*

Keep a Long-Term Perspective

Even with a Brexit-induced sell-off in risk assets, many well diversified portfolios have remained in positive territory year-to-date. Investors likely will proceed with caution in the near term as the potential implications of Brexit are assessed. Focus will then shift to the upcoming U.S. elections, while many investors will continue to worry about assets that could be overvalued in a low-growth environment. Investors want to know how these events and conditions should impact their investment decisions. Some are even converting their assets to cash out of fear that such developments might cause markets to fall. Indeed, these types of events can affect the financial markets, but tactical opportunities also may arise as a result.

Chart 1: Volatility Can Offer Opportunity: A Longer-Term View of the MSCI World Index

Source: Bloomberg, MSCI, 6/28/16. Past performance is no guarantee of future results.

Further, as Chart 1 shows, such events have often been reduced to a blip in the long-term trend. Even serious financial crises, like the one that contributed to the 2008 market downturn, are typically reversed over the course of the market cycle.

It is important, therefore, to think about why you are investing. Are you putting away money for retirement? Are you already retired and managing your assets to provide income for living expenses now and growth for future expenses? Are you hoping to leave a legacy to a favorite charity one day? As you consider your reasons for investing, think about how long it will be before you will need the money to fund your goals. Is it within a few months? A year from now? A decade or more in the future?

There are several things to consider when you are determining which assets (and in what proportions) to include in your portfolio. Your ability to wait out market downturns is one of the most important considerations. This ability is often tied closely to when you need to convert your assets to cash. The time between now and when you need cash is your time horizon. Let's review how your time horizon and asset class choices relate.

Short Term

If you are investing for a near-term goal, such as college funding for children now in college—and you have money set aside for next year's tuition—cash alternatives (such as money market instruments) are an appropriate asset class for this investment goal.

Medium Term

If you are investing for a medium-term goal, such as a home purchase in five years, then cash alternatives, bonds and some equities might be an appropriate mix of assets. As you get closer to the time you will need to make a down payment, you could gradually shift the allocation to 100-percent cash.

Long Term

Goals like legacy planning, retirement or even funding during retirement can have time horizons that are decades long. Long-term goals should be matched with assets that are expected to accomplish those goals. Typically, a minimum requirement is that your asset returns exceed inflation and provide some level of growth. Returns on cash-alternative investments, and many short-term and medium-term bond yields, are not exceeding inflation today. That makes these assets less attractive for long-term portfolios, although a modest allocation may help to mitigate portfolio volatility. We expect assets like domestic and international stocks, high-yield bonds and real estate investment trusts (REITs) to provide higher returns than inflation, cash alternatives and short-term bonds—and are typically more sizable components of portfolios with long-term goals.

As you think about the time when you will need to convert your investment assets to cash, you should apportion less volatile, more liquid assets in your portfolio to provide funding ahead of that conversion. Money in your portfolio that does not need to be converted in the near term could be invested in asset classes with higher expected returns and higher expected volatility to provide growth. Near-term events, fair-to-stretched asset valuations and low growth expectations are not sufficient reasons to avoid investing for the longer term. We suggest that you talk with your investment professional about your goals and when you will need cash to fund those goals. Then, we recommend that you keep in mind the fact that, for many goals, you have time to wait out near-term disruptions like those attributed to macro events.

Risk Factors

All investing involves some degree of risk, whether it is associated with market volatility, purchasing power or a specific security. Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments.

Investments in fixed-income securities are subject to interest rate and credit risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and principal. High yield fixed income securities are considered speculative, involve greater risk of default, and tend to be more volatile than investment grade fixed income securities. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility.

There are special risks associated with an investment in real estate, including the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

Past performance cannot guarantee future results.

Definitions

An index is not managed and not available for direct investment.

The MSCI World Index captures large- and mid-cap equity representation across 23 developed-market countries. With 1,639 constituents, the index covers approximately 85 percent of the free float-adjusted market capitalization in each country.

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