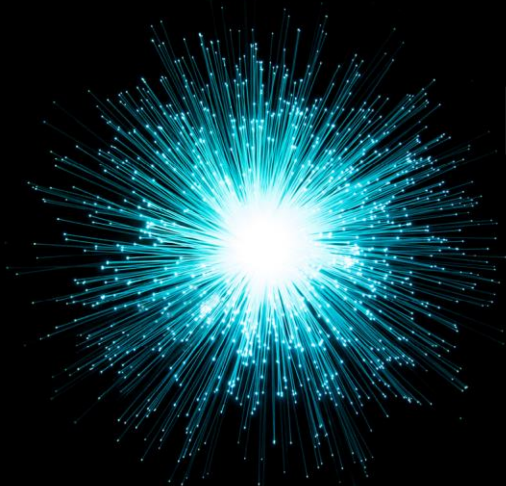


Make diversification a part of your investment journey

It's time to stop chasing the past. The latest Russell Investments/ASX Long-Term Investing Report shows how it's becoming harder to rely on previous asset class 'winners' and why it's a smart move to stay diversified.

JULY 2018

'Past performance is not a reliable indicator of future performance'—wise words for the savvy investor to live by, wouldn't you agree? These words have never been truer—just look at the findings of the latest Russell Investments/ASX Long-Term Investing Report, which cautions Australian investors who rely on a single asset class to achieve long-term investment goals.

One of the biggest findings from the report is that asset classes move from top to bottom spots quite quickly. We know this because we compared the gross returns of 10 years and 20 years to December 2017 to previous results measured to December 2016. Here are some findings that really stood out.

Australian residential property took the top spot in 2001 and 2002, but also came last (below cash and Australian bonds) in 2004 and 2005. Moreover, last year, residential property underperformed global shares hedged by more than 10%.

Global (hedged and unhedged), Australian shares and Australian listed property rankings fluctuated the most, taking both top and bottom spots year on year, reflecting the higher risks in these asset classes.

Global and Australian fixed income rankings were less volatile, but still changed from year to year.

The multi-asset portfolio (represented by the 70% sample growth fund) experienced the most consistent ranking, enjoying 19 out of 20 years of positive returns.

And when we looked at the best and weakest annual performance for the last 20 years, it was clear that the 'winner' for each year changed so significantly and led to so much variation, that it was very hard to predict next year's winner. This means if you've been chasing previous asset class 'winners' as your investment strategy, it's time to stop.

Residential property and global shares, for example, each flipped from the best-performing asset class in the group for a particular year only to rank in a subsequent year as the worst. Meanwhile, the multi-asset portfolio measure experienced a more consistently positive, smoother journey throughout the two decades.

Impact on investor returns

The more susceptible you are to chasing last year's winners or adopting strategies based on their predictions, the less likely you are to get higher returns.

For example, an Australian investor who switched to follow the previous year's 'winner' each year would have a portfolio 29% worse off, compared to staying invested in a sample balanced fund throughout the 20-year period.

So, what's the answer?

Stay invested in diversified portfolios

That's right. The hindsight that comes from a report with a 20-year history supports the value in diversification across asset classes.

A strategy that diversifies across multiple asset classes and relies on different types of return drivers is more likely to result in a smoother investment journey and increase the chances of achieving your long-term goals.

And if you're an investor who doesn't have too much flexibility or if you're not sure when you need to move out of your investments (for example, nearing retirement), you may want to pay more attention to the order and timing of investment returns. Remember, risk/return patterns identified over the long term, may not always hold true for shorter investment time frames.

A tale of two investors

While it's easy to talk about the importance of knowing the benefits of diversification, we demonstrate it using two different approaches—'do it yourself' and dynamically-managed.

DIY or dynamic?
'Do-it-yourself' or DIY portfolios are more domestically oriented and exposed to less liquid assets
Dynamically-managed multi-asset portfolios are more globally-diversified across different investment strategies and return sources

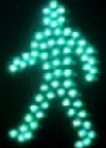
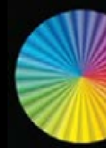
Our comparison of these two approaches looks at average asset allocation, extent of portfolio diversification, diversity of managers and strategies, and how asset allocations change with changing market conditions. Find out where you belong

Time to shake off behavioural bias

To be a successful investor, it's important to master the art of buying low and selling high; to be objective and disciplined when making decisions; to go beyond home country-specific investments; and to always keep your overall investment strategy in mind.

But, as we are, first and foremost, human, and because we're investing in a world of uncertainty, it's easy to let our behavioural biases get the better of us, and make decisions that are detrimental to our portfolios.

We've identified four common biases: herding, overconfidence, familiarity and mental accounting, and the behaviours linked to each bias.

Overconfidence	Herding	Familiarity	Mental accounting
Humans tend to over-estimate or exaggerate their ability to successfully perform tasks	Humans tend to mimic the actions of the larger group	Humans tend to prefer what is familiar or well-known 	Humans tend to separate their money into separate accounts 
Trade too often	Buy high, sell low	Overweight home country	Naive diversification

Do you see any of these biases in the way you invest? If so, what can you do to avoid them? Staying invested in diversified, multi-asset portfolios is the way to go. At Russell Investments, our portfolio managers live by a few simple truths that you could look to adopt to stay diversified:

- recognise and openly accept biases—your first step to overcoming biases
- seek out challenge from outside to avoid group think and to keep things impartial
- recognise that sometimes it's the decisions you choose NOT to make that count more
- review decisions by documenting all the steps of the decision-making process
- measure the probability versus the impact of events.

Identify and overcome your biases

What's your investment journey like?

We hope the insights in the latest Russell Investments/ASX Long-Term Investing Report can help you to understand the importance of diversification—leading to a smooth and comfortable investment journey.

Want to delve deeper into our insights? Keen to see the detail that sit behind our analysis? Or maybe you're interested in knowing why balanced and growth funds fared relatively well in 2017. There's only one thing to do…

Wondering what this report is all about?

The Russell Investments/ASX Long-Term Investing Report is the only widely available report that provides Australian investors with a comprehensive and factual comparison between the long-term returns of Australian residential investment property and key domestic and global asset classes. The report also takes into account the impact of tax and gearing as well as the benefits of investments held within the superannuation system.

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