Vanguard 2016 Index Chart

Putting market moves into long-term perspective

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Tuning out short-term market noise and staying focused on a long-term investment strategy isn’t always easy. To reach long-term financial goals investors need to have a clear vision of where they want to go as well as a disciplined investment approach to guide them along the way.

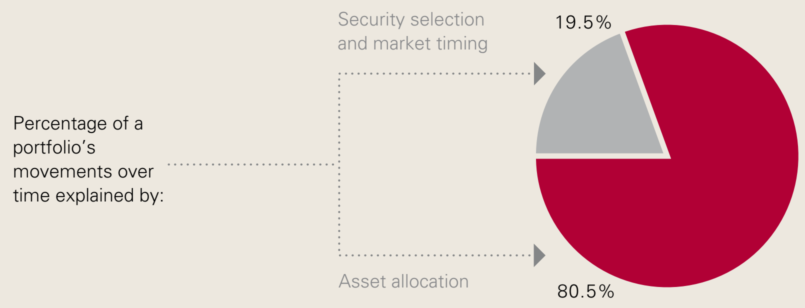
The Vanguard index wall chart tracks the 26 year investment performance of major asset classes and highlights key economic, social, political and demographic changes. Looking at markets over this longer time period supports some key philosophies that can help investors keep long-term investment success clearly in sight.

Focus on strategic asset allocation

Strategic asset allocation is the process of combining different asset classes, such as equities and bonds, in a mix that aligns with an investor’s goals and their attitude to risk.

Research shows that effective asset allocation is the key to long-term investment performance.

The chart below is from a study Vanguard conducted which looks at the returns of nearly 750 fund managers across 25 years. It found that asset allocation was responsible for more than 80% of the return patterns of diversified portfolios (i.e. those featuring a range of asset classes such as equities and bonds) over time. This leaves less than 20% for factors such as market timing (trying to take advantage of market moves to buy low and sell high) or securities selection (choosing individual shares or bonds that you think are going to perform better than the market).



Note: Calculations are based on monthly returns for 743 UK balanced funds from January 1990 to September 2015. For details of the methodology, see the Vanguard research paper *The Global Case for Strategic Asset Allocation and an examination of home bias* (Scott et al., 2016v).
Source: Vanguard calculations using data from Morningstar.

That’s why it is important for investors to dedicate time to asset allocation decisions before they start investing – it can mean the difference between achieving their goals or simply aspiring to them.

Having a clear understanding of your objectives, investment timeframe and attitude to risk provides a firm foundation on which to build an investment portfolio. The more specific investors are, the better their chances of success.

Invest for the long term

Market cycles play out against a backdrop of economic, social and political events and many investors can’t resist trying to assign causes to every hiccup in the markets. But it’s often impossible to explain market activities until long after the dust has settled.

Markets are unpredictable and trying to time them means investors must get two important decisions right: when to get out and when to get back in. This means there is a risk of having to pay a higher price to get back into the market, as well as missing out on the growth from any market recovery.

Allowing emotions to drive investment decisions, be it overconfidence in rising markets or fear in falling markets, rarely serves investors well.

Historical market returns show that investors who ignore the emotional swirl of short-term market conditions and focus on the long term are rewarded for their patience and discipline.

Diversify

The index chart illustrates the benefit of diversifying investments across asset classes to help reduce the ups and downs in a portfolio and smooth out returns over time. Diversification often starts by investing across different asset classes but it also includes holding a spread of investments within an asset class across a range of companies, industries and even countries.

While this strategy doesn’t protect a portfolio against negative returns, it does reduce the impact of poorly performing asset classes.

Keep costs low

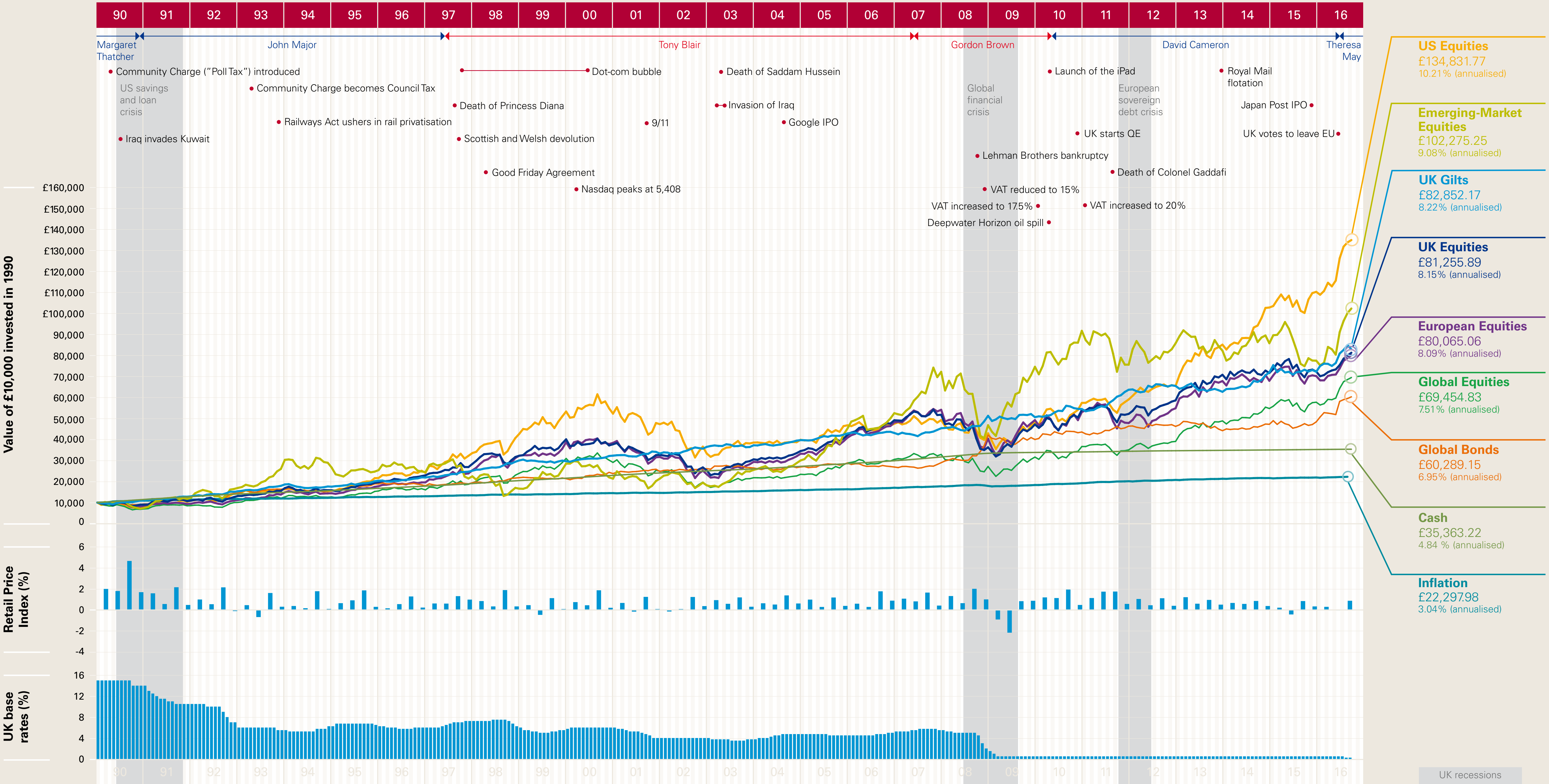
All else being equal, investments with consistently low management fees and transaction costs can provide a head start in achieving competitive returns.

Management fees create a drag on returns that can make it more difficult for a fund manager to add value. Factors such as high portfolio turnover within a fund (i.e. heavy trading of underlying shares or bonds) can also lower its tax efficiency and drive up transaction costs.

The bottom line is – lower fees mean investors get to keep more of their returns.

Vanguard™ 2016 Index Chart

Market returns – 31 December 1990 to 30 September 2016



Notes: Cash = ICE LIBOR – GBP 3 Month; Global Equities = The MSCI World Index; US Equities = S&P 500; UK Equities = FTSE All-Share; Inflation = Retail Price Index, (Jan 1987=100); Global Bonds = Barclays Global Aggregate; European Equities = MSCI Europe; UK Gilts = Benchmark 10-year gilt; Emerging Market Equities = MSCi Emerging Markets; all shown gross of taxes and in GBP. Source: Bloomberg and Factset, as at 30 September 2016.

Past performance is not a reliable indicator of future results.

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The power of diversification

The table below shows the performance of various asset classes and inflation over the past 26 years.

	Inflation	Cash	UK Equities	European Equities	US Equities	Global Equities	Global Bonds
1990	9.34	14.81	-9.72	-19.18	-18.96	-30.18	-6.98
1991	4.46	11.56	20.80	17.10	34.42	22.57	19.56
1992	2.58	9.70	20.49	18.32	32.98	17.81	30.73
1993	1.94	5.99	28.39	32.63	12.49	25.82	13.51
1994	2.89	5.56	-5.85	-2.75	-4.02	0.01	-5.05
1995	3.22	6.75	23.85	23.07	38.63	22.25	20.58
1996	2.46	6.13	16.70	10.29	11.56	3.42	-4.82
1997	3.63	6.91	23.56	29.17	38.70	20.88	7.94
1998	2.75	7.42	13.77	27.48	27.16	23.42	12.45
1999	1.76	5.54	24.20	19.99	24.95	29.39	-2.11
2000	2.93	6.20	-5.90	-0.89	-1.93	-6.05	11.32
2001	0.70	5.04	-13.29	-17.52	-9.56	-14.32	4.25
2002	2.94	4.06	-22.68	-25.95	-29.58	-27.26	5.34
2003	2.80	3.73	20.86	25.13	15.73	20.29	1.18
2004	3.49	4.65	12.84	13.18	3.39	7.46	1.89
2005	2.21	4.76	22.04	22.94	17.33	23.04	6.82
2006	4.43	4.85	16.75	17.85	1.57	5.83	-6.46
2007	4.05	6.00	5.32	12.47	3.72	7.72	7.64
2008	0.95	5.53	-29.93	-25.35	-12.77	-17.39	45.08
2009	2.40	1.21	30.12	21.81	12.60	16.45	-4.80
2010	4.77	0.70	14.51	7.77	18.68	15.87	8.86
2011	4.82	0.87	-3.46	-9.84	2.87	-4.31	6.43
2012	3.09	0.83	12.30	14.66	10.91	11.42	-0.26
2013	2.67	0.51	20.81	23.62	29.93	25.00	-4.41
2014	1.62	0.54	1.18	0.18	20.76	12.07	6.84
2015	1.20	0.57	0.98	3.31	7.25	5.45	2.45

= Best performer (excluding inflation)

= Worst performer (excluding inflation)

Notes: Cash = ICE LIBOR – GBP 3 Month; Global Equities = The MSCI World Index; US Equities = S&P 500; UK Equities = FTSE All-Share; Inflation = Retail Price Index, (Jan 1987=100); Global Bonds = Barclays Global Aggregate; European Equities = MSCI Europe; all shown gross of taxes and in GBP

Past performance is not a reliable indicator of future results.

When deciding where to invest their money, it is important investors understand that the best and worst performing asset classes will often vary from one year to the next. Having a diversified mix of investments across multiple asset classes can help smooth out returns over time.

The table also reinforces the importance of sticking to an investment strategy and focusing on the long term. For example, the low returns from equity markets in 2008 may have swayed investors to move out of this asset class in search of better returns elsewhere. In taking this option, investors would have missed out on some significant subsequent returns.

What makes us different

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