Strategic: Strengthen your core

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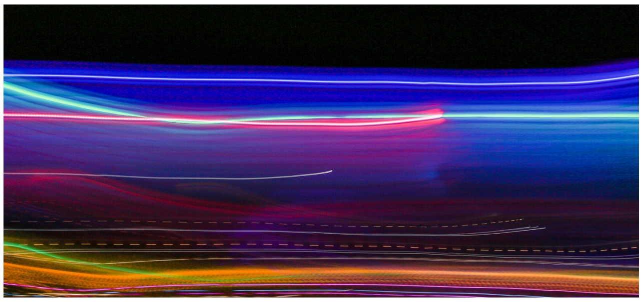
Why? Building a core portfolio can help maintain focus on long-term goals amid market volatility and distracting headlines. A portfolio diversified across asset classes, geographies, and sectors can consistently grow wealth, providing compounded returns. This approach helps maximize the chance of meeting financial goals, allowing investors to pursue other interests or tactical opportunities with greater confidence.



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Investors always have to contend with uncertainty. It may be around geopolitics, the implications of national tax and spending plans, or the path for interest rates. Uncertainty can drive market volatility. And when markets fluctuate, investors risk flocking to "less risky" assets like cash or more familiar assets like their local stock market.

While steadier in the near term, overexposure to cash can lead investors to miss out on returns and jeopardize their long-term goals. And excessive home biases in equities can leave investors especially exposed to the domestic growth and political cycle, or underexposed to market segments that may be important drivers of global equities but little represented in certain domestic indexes.

To avoid letting uncertainty and volatility derail financial plans, we believe that investors should implement a “core” component in their wealth management strategy. The core should be a portfolio diversified effectively across asset classes, geographies, and sectors, and left alone to grow wealth consistently for the long term.
Doing so has borne fruit over the past 125 years according to the Global Investment Returns Yearbook. Historical data show that over the long term, a 60:40 US-blended portfolio of US stocks and Treasury bonds has historically delivered an annualized real return of 5.1% in local currency terms (versus 6.6% for stocks and 1.6% for bonds), with lower volatility at 13.4% compared to stocks alone at 19.8% and 10.7% for bonds. The study also finds the volatility (standard deviation) of US dollar after-inflation returns for a typical single-country equity investment is 29.1%, falling to 17.2% for a capitalization-weighted 21-country equity index.

We believe the benefits of a core diversified portfolio are threefold:

It can maximize the chances of consistently growing wealth.
Historically, no asset class has consistently outperformed others year after year. For instance, while equities may deliver the highest returns in one decade, commodities or real estate might take the lead in another. Looking at the annual returns of 14 major asset class returns since 1999, the best-performing asset class in one year has had a roughly 40% chance of experiencing a loss in the year after, versus 27% for a randomly chosen asset class and 31% for a well-diversified portfolio.

By diversifying, investors do not need to try to predict which asset will perform best; instead, they can benefit from the potential gains of multiple assets, which helps to smooth out returns over time. Diversifying also helps investors gain exposure to the small number of securities that historically drive stock gains. Indeed, a study by Arizona State University professor Hendrik Bessembinder showed that just 0.3% of firms accounted for half of US stock market wealth creation between 1926 and 2019.

Building a core portfolio can help investors stay in the market through volatility. Investing in a core portfolio helps investors remain committed to their long-term financial goals, even during periods of market volatility. A well-structured core portfolio is designed to weather the ups and downs of financial markets, providing a stable foundation for wealth growth. This approach allows investors to focus on their long-term objectives without being swayed by short-term market fluctuations. By maintaining a diversified core, investors can benefit from the compounding of returns over time, which is crucial for achieving financial security and growth. Indeed, while markets can be volatile in the short term, they generally grow over the long term. Looking at the S&P 500 index and different holding periods since 1926, we observe that the chance of making a positive total return over any monthly timeframe is 63%, but climbs to 75% for any 12-month window and 100% for any 20-year period.

Investing in a core portfolio can free up capital and time for other opportunities. Building a core portfolio allows investors to delegate the complexities of investment management to professionals, freeing up time and money to pursue other opportunities. This approach not only reduces the burden of managing individual investments but also should ensure that the portfolio is continuously optimized to meet income and growth targets. For example, investors with a well-diversified portfolio satisfying their income objectives for today and their lifetime may have greater scope to focus on strategic investment opportunities to grow capital for spending beyond their lifetime, including alternative investments in fields such as private markets.

More resources:

How to manage equity allocations near all-time highs

Report: CIO Tutorial (update): Why diversification is unsatisfying but important

Blog: Diversification is uncomfortable

Appendix

Risk information
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