Shaw and Partners
Morrissey Group

Diversification – Sow the seeds

Diversification is commonly misunderstood by investors. In simple terms, it is a concept of combining asset classes to manage risk.

Having diversification helps you to focus on what is in your control, which is the exposure to risk, how you react when the 'unexpected' inevitably happens and adjusting your portfolio accordingly.

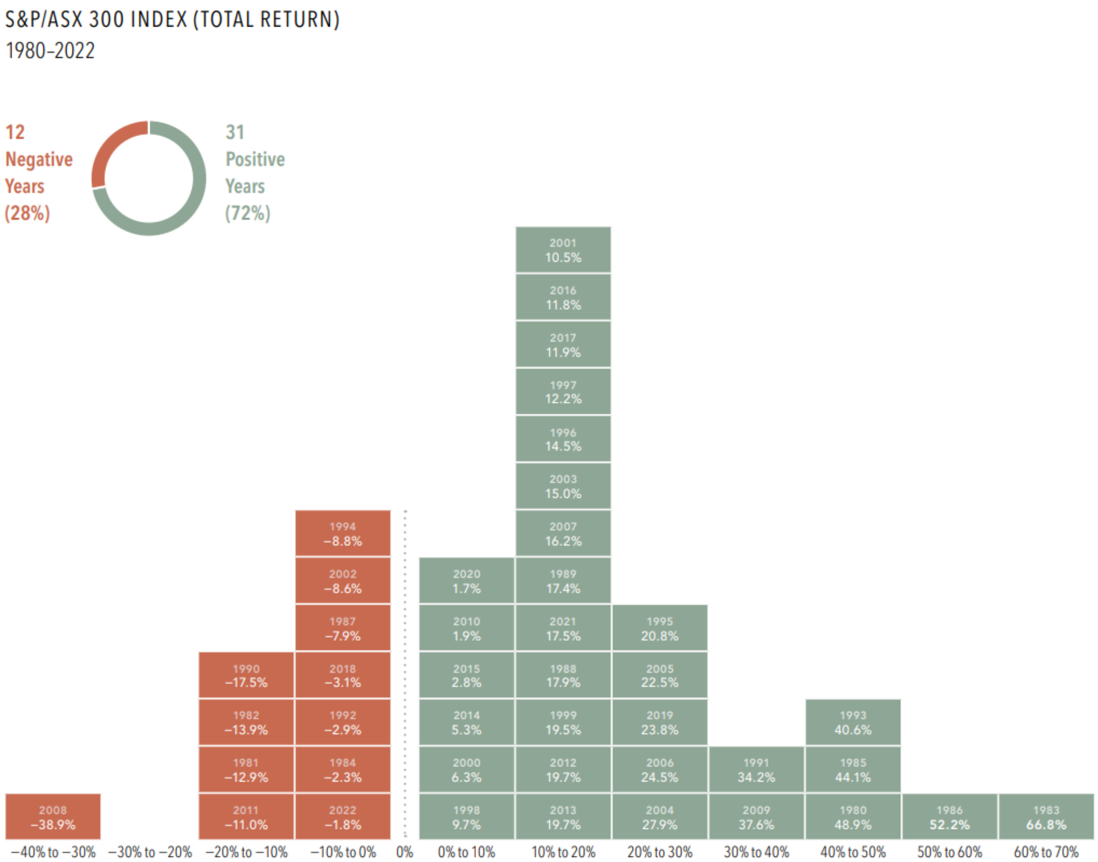
Your strategic asset allocation is your long term asset mix position, based on your risk profile, needs and goals. Tactical asset allocation is where you adjust your strategic asset allocation to increase or decrease the % of an asset class based on short term views or situations.

Diversification is not a set it and forget process

The appropriate strategic asset allocation depends on your goals, objectives, risk tolerances, and time horizon. There is no one size fits all approach.

Once you know these factors, being broadly diversified and staying the course are critical to achieving a positive outcome. Now staying the course does not mean standing still. It involves sticking to an asset allocation, rebalancing as circumstances change and looking through the short-term market movements.

In the short term, equity market returns are for the most part, unpredictable. However, if history is anything to go by, it has demonstrated there are more positive periods than negative. Positive years have historically occurred more frequently (31 times) than negative years (12 times) on the ASX300 Index from 1980 to 2022, with an average gain of 10.8% per annum during this 42-year period*.

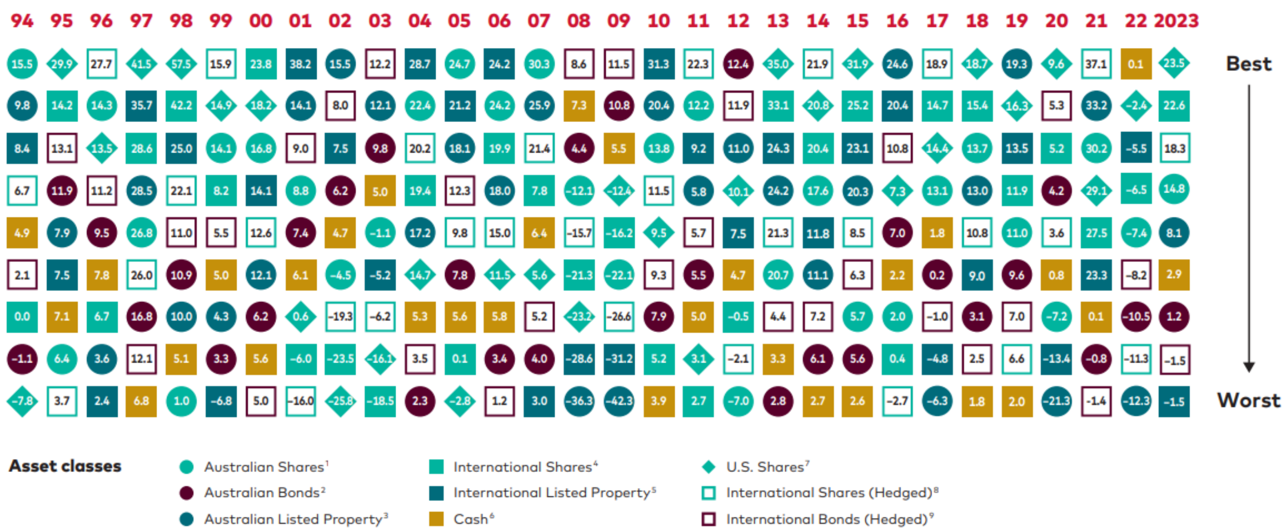


Source: Dimensional – Rewarding distribution of Australian Stock Market Returns. * Disclaimer: Past performance is not an indicator of future performance.

If we dive into the detail, it is clear there not one particular asset class that continually comes out on top each year.

A diversified mix of investments across multiple asset classes can help smooth out returns.

This is our favourite chart showing why you should diversify. Don't focus on the numbers in each shape, but look at the colours and shapes from year to year. Last year's worst performer can turn into next year's best, and vice versa.

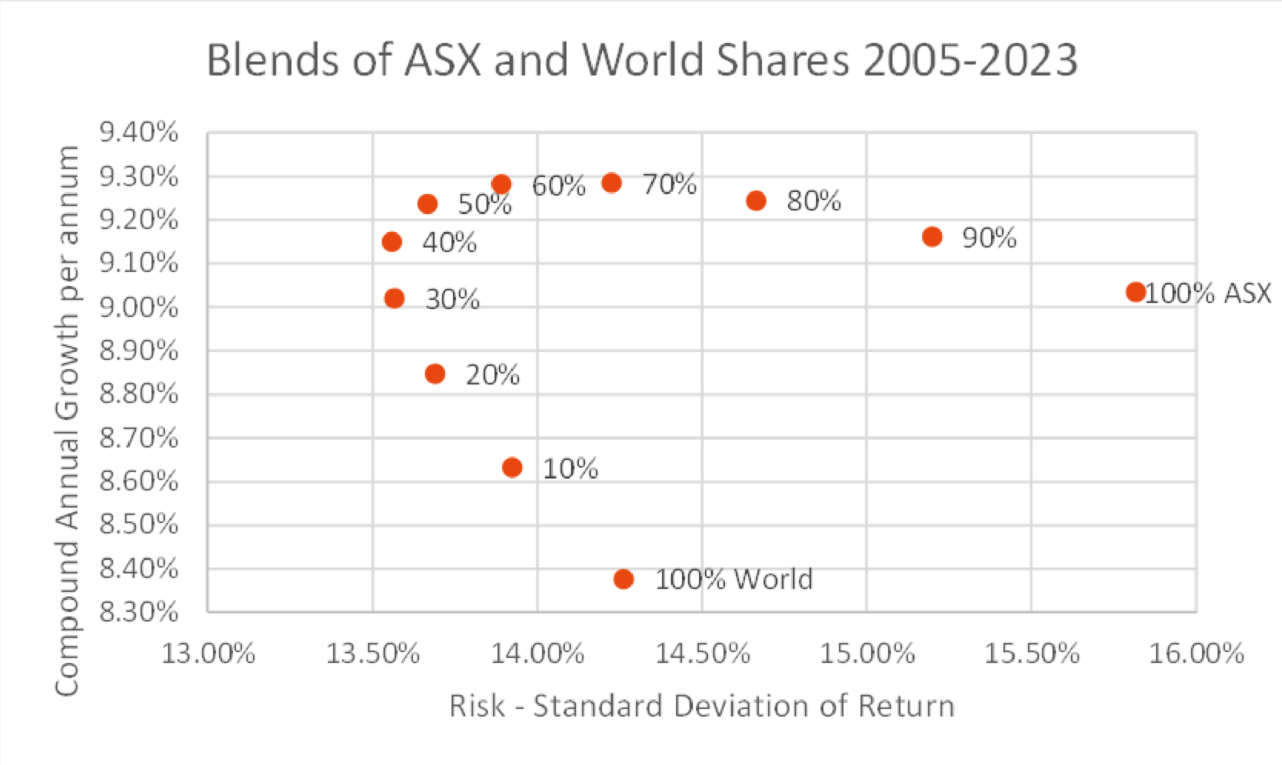


Source: Andex Charts Pty Ltd, June 2023.

It also shows that if you are 100% exposed to one or even two asset classes, you're significantly increasing your risk.

The 'Efficient Frontier' is the mix of assets in a portfolio that will offer the highest expected return for a level of risk. The theory was introduced by Harry Markovitz in 1952, and shows that if you blend two or more asset classes (we've used ASX and World shares below) you can expect a higher return for a lower level of anticipated risk.

For example, a portfolio of 100% ASX is expected to return around 9.05% growth, with a standard deviation – risk – of 15.75%. If you blend however, say 60% ASX and 40% World, you'll increase the expected return to 9.3% and lower the standard deviation to 13.8%.

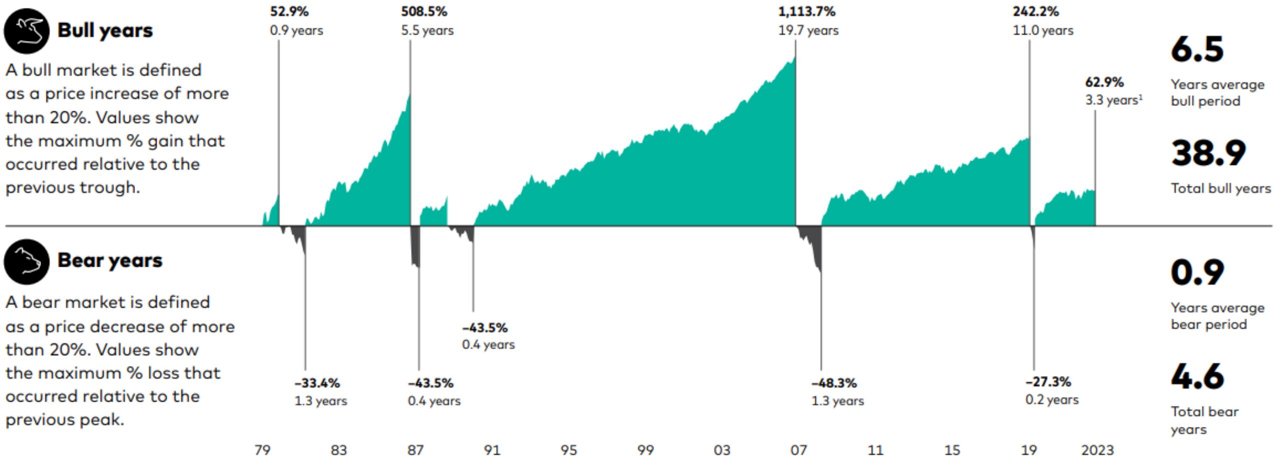


* S&P/ASX Franking Credit Adjusted Total Return Index, MSCI World $A Gross Total Return Index

Returns are important, but goals matter more

Downturns are not rare events. As the below graphic indicates, there have been multiple declines and rallies over the years, but overall, the rallies have been more pronounced and often longer. Remember the 'why' behind your investment strategy and focus on whether you are still on track to meet your goals.

How bull and bear markets have impacted returns over the past 40+ years.

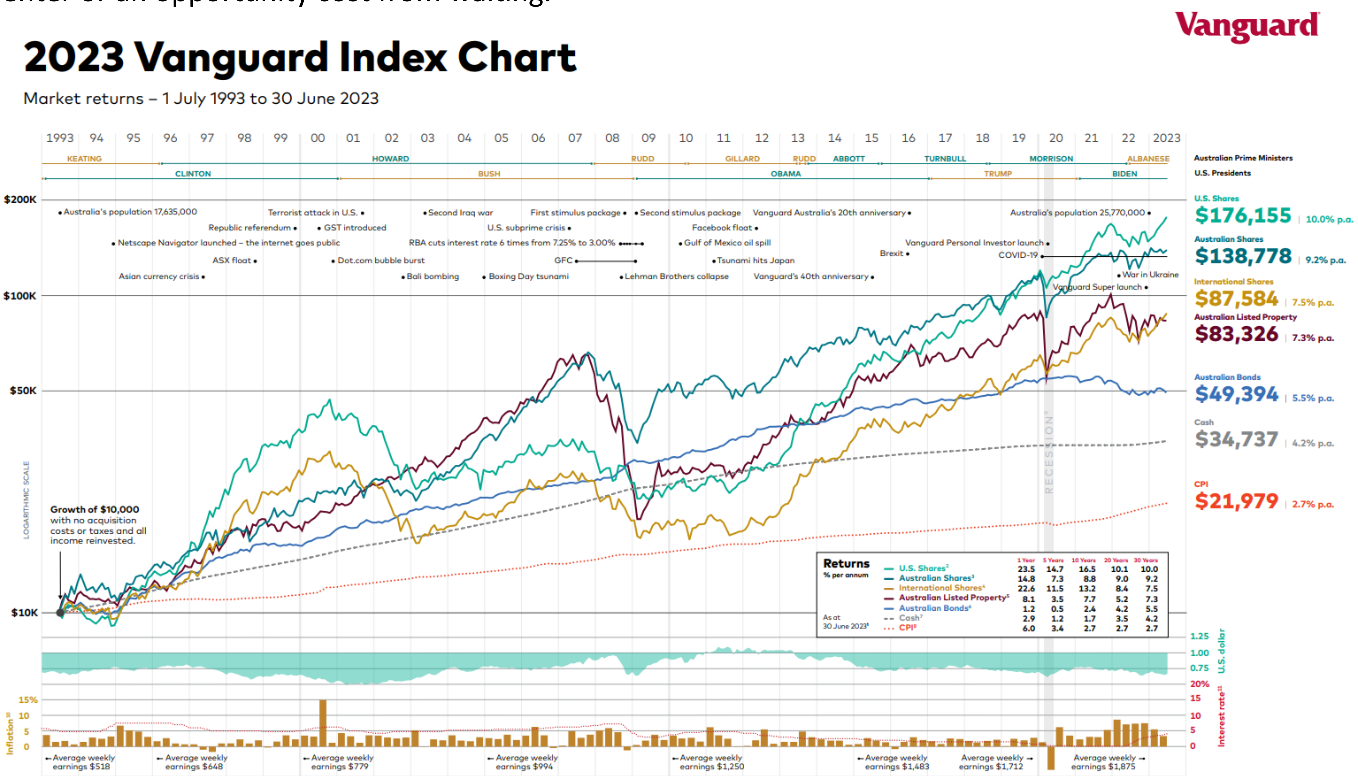


Sources: Vanguard, Global Financial Data, Refinitiv. Notes: 1. The latest bull run is still ongoing. Calculations are based on S&P/ASX All Ordinaries Total Return index and data aggregated from Global Financial Data. A bear (bull) market is defined as a price decrease (increase) of more than 20%. The plotted areas depict the losses / gains ranging from the minimum following a 20% loss to the respective maximum following a 20% appreciation in the underlying index. Time period: 31/12/1979 to 30/6/2023. Calculations based on monthly data. Logarithmic scale on y axis.

It's the long-term story that really counts

Short-term market events tend to grab headlines and cause havoc, but for investors, the long-term trend should be the focus. It is easy to react emotionally to short, quick market movements.

Timing the market means you need to get two important decisions right: when to get out and when to get back in, and vice versa. Get either wrong and you may be paying a higher price to re-enter or an opportunity cost from waiting.



Sources: Australian Bureau of Statistics, Bloomberg Finance L.P., Melbourne Institute of Applied Economic & Social Research, MSCI Inc., Standard & Poor's, WM Reuters. Notes: 1. Per annum total returns to 30 June 2023. 2. S&P 500 Total Return Index (in AUD). 3. S&P/ASX All Ordinaries Total Return Index. 4. MSCI World ex-Australia Net Total Return Index AUD Index. 5. S&P/ASX 200 A-REIT Total Return Index. 6. Bloomberg AusBond Composite 0+ Yr Index. 7. Bloomberg AusBond Bank Bill Index. 8. ABS Consumer Price Index. 9. Recessions as defined by the Melbourne Institute of Applied Economic and Social Research. 10. Annualised Rate of Inflation. 11. Interest Rate is the Reserve Bank of Australia's Official Cash Rate. All figures are in Australian dollars. All marks are the exclusive property of their respective owners. Past performance information is given for illustrative purposes only and should not be relied upon as, and is not, an indication of future performance.

We offer asset allocation and investment advice, and we'd love to hear from you. Please contact us on 03 9268 1118 or ahenderson@shawandpartners.com.au to discuss our services further.

Alex, Anu and the team.

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