

Lessons for the Next Crisis

It is now the 10-year anniversary of when, in early October 2007, the S&P 500 Index hit what was its highest point before losing more than half its value over the next year and a half during the global financial crisis.

Over the coming weeks and months, as other anniversaries of major crisis-related events pass (for example, 10 years since the bank run on Northern Rock or 10 years since the collapse of Lehman Brothers), there will likely be a steady stream of retrospectives on what happened as well as opinions on how the environment today may be similar or different from the period leading up to the crisis. It is difficult to draw useful conclusions based on such observations; financial markets have a habit of behaving unpredictably in the short run. There are, however, important lessons that investors might be well-served to remember: Capital markets have rewarded investors over the long term, and having an investment approach you can stick with—especially during tough times—may better prepare you for the next crisis and its aftermath.

BENEFITS OF HINDSIGHT

In 2008, the stock market dropped in value by almost half. Being a decade removed from the crisis may make it easier to take the past in stride. The eventual rebound and subsequent years of double-digit gains have also likely helped in this regard. While the events of the crisis were unfolding, however, a future of this sort looked anything but certain. Headlines such as “Worst Crisis Since ’30s, With No End Yet in Sight,”¹ “Markets in Disarray as Lending Locks Up,”² and “For Stocks, Worst Single-Day Drop in Two Decades”³ were common front page news. Reading the news, opening up quarterly statements, or going online to check an account balance were, for many, stomach-churning experiences.

While being an investor today (or during any period, for that matter), is by no means a worry-free experience, the feelings of panic and dread felt by many during the financial crisis were distinctly acute. Many investors reacted emotionally to these developments. In the heat of the moment, some decided it was more than they could stomach, so they sold out of stocks. On the other hand, many who were able to stay the course and stick to their approach recovered from the crisis and benefited from the subsequent rebound in markets.

1. <http://wsj.com/articles/SB122169431617549947>

2. washingtonpost.com/wp-dyn/content/article/2008/09/17/AR2008091700707.html

3. <http://nytimes.com/2008/09/30/business/30markets.html>

It is important to remember that this crisis and the subsequent recovery in financial markets was not the first time in history that periods of substantial volatility have occurred. **Exhibit 1** helps illustrate this point. The exhibit shows the simulated performance of a balanced investment strategy following several crises, including the bankruptcy of Lehman Brothers in September of 2008, which took place in the middle of the financial crisis. Each event is labeled with the month and year that it occurred or peaked.

Exhibit 1. The Market's Response to Crisis
Simulated Performance of a Balanced Strategy: 60% Stocks, 40% Bonds
(Cumulative Total Return)

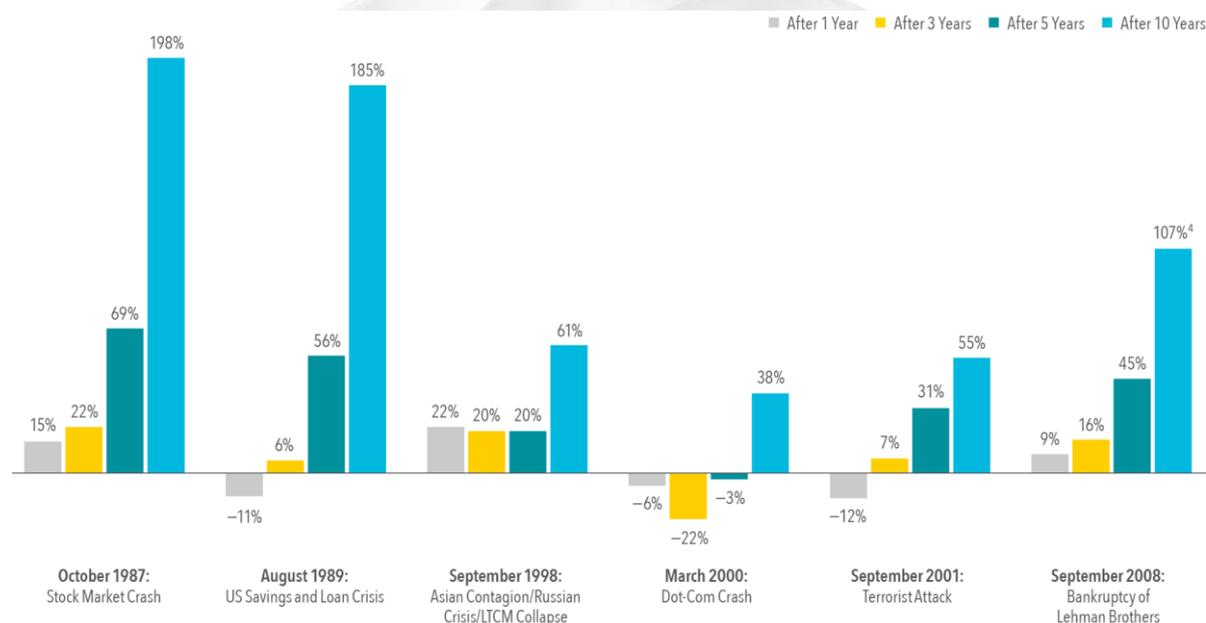


Exhibit 2. Performance as at 30 September 2017

Cumulative Returns (%)	1 Year	2 Years	3 Years	4 Years	5 Years
Balanced Strategy 60/40 (GBP)	8.69	28.69	31.47	42.41	60.20

Simulated strategy returns based on a model/back-tested simulation using 60% MSCI World Index (gross div., GBP) and 40% Citi World Government Bond Index 1-5 Years (hedged to GBP). Citi Indices used with permission, © 2017 by Citigroup. MSCI data © MSCI 2017, all rights reserved. Rebalanced monthly. This is not a strategy managed by Dimensional Fund Advisors Ltd., or any of its affiliates.

The performance was achieved with the retroactive application of a model designed with the benefit of hindsight; it does not represent actual investment performance. Back-tested model performance is hypothetical (it does not reflect trading in actual accounts) and is provided for informational purposes only. The securities held in the model may differ significantly from those held in client accounts. Simulated performance may not reflect the impact that economic and market factors might have had on the advisor's decision making if the advisor were actually managing client money. This strategy was not available for investment in the time periods depicted. Actual management of this type of simulated strategy may result in lower returns than the back-tested results achieved with the benefit of hindsight.

Past performance (including hypothetical past performance) does not guarantee future or actual results. Performance may increase or decrease as a result of currency fluctuations. The simulated performance shown is "gross performance," which includes the reinvestment of dividends but does not reflect the deduction of investment advisory fees and other expenses. A client's investment returns will be reduced by the advisory fees and other expenses it may incur in the management of its advisory account.

4. In the case of September 2008, the return relates to the available data of 9 years through 30/09/2017.

Although a globally diversified balanced investment strategy invested at the time of each event would have suffered losses immediately following most of these events, financial markets did recover, as can be seen by the three-, five- and ten-year cumulative returns shown in the exhibit. In advance of such periods of discomfort, having a long-term perspective, appropriate diversification, and an asset allocation that aligns with their risk tolerance and goals can help investors remain disciplined enough to ride out the storm. A financial adviser can play a critical role in helping to work through these issues and in counseling investors when things look their darkest.

CONCLUSION

In the mind of some investors, there is always a “crisis of the day” or potential major event looming that could mean the beginning of the next drop in markets. As we know, predicting future events correctly, or how the market will react to future events, is a difficult exercise. It is important to understand, however, that market volatility is a part of investing. To enjoy the benefit of higher potential returns, investors must be willing to accept increased uncertainty. A key part of a good long-term investment experience is being able to stay with your investment philosophy, even during tough times. A well-thought-out, transparent investment approach can help people be better prepared to face uncertainty and may improve their ability to stick with their plan and ultimately capture the long-term returns of capital markets.

APPENDIX

The model's performance does not reflect advisory fees or other expenses associated with the management of an actual portfolio. There are limitations inherent in model allocations. In particular, model performance may not reflect the impact that economic and market factors may have had on the adviser's decision making if the adviser were actually managing client money. The balanced strategies are not recommendations for an actual allocation.

Do not act on this information alone! Always seek independent financial advice before taking any action.

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