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Lessons from the coronavirus: keep things simple when it comes to investment

With two major shocks hitting global markets so far in 2020, the case for a straightforward approach to investment has been thrown into relief...

There are a multitude of investment products now on the market. From index funds, offering returns that simply track the market at limited cost, to region-specific funds, which look to profit from predicting the direction of evolving economies, investors are faced with an almost limitless choice.

But, for investors seeking to achieve long-term active returns from their investment portfolios, the multiplicity of funds can be confusing and a barrier to investment. Each of the world's markets and asset classes has very different risk profiles from the other – meaning that the context in which they are most likely to experience losses varies greatly. Balancing these risks across a portfolio overall can require a significant degree of investment knowledge and also requires investors to keep a watchful eye on their portfolios.

Full of surprises

At the same time, trying to anticipate key risks is fraught with danger. After just a month and a half of 2020, investors have already faced not one but two profound shocks, both of which could have a far reaching impact. In early January, a US drone strike killed Iranian general Qassem Soleimani, prompting professional investors to flood into bond funds in a bid to find an investing safe haven in the event of war. On the other hand, equity funds – especially in the US – saw mass outflows. While the immediate effect was short lived, as the threat of war rapidly subsided in the days after the strike, the incident demonstrated how quickly professionals react to these events and how ordinary investors can be left to catch up.

The impact of the coronavirus epidemic, centered in China, is unlikely to have such a short lifespan. The Chinese government has taken extreme measures to control the virus, essentially shutting down all but the Chinese economy's core functions for weeks in a bid to prevent it spreading. The scale of these events was unprecedented and could have an impact on global markets for some time to come, as many economists believe the effects are only now beginning to be felt.

Both Iran and the coronavirus have reminded us once again that 'black swan' macroeconomic events are impossible to predict, despite their significant implications, and near impossible to factor into investment decisions. As a result, investing heavily in

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a particular region, sector or investing style means you may be overexposing a portfolio to unforeseen risk.

Keeping things simple

While there is a place for allocating to multiple funds across different categories, for many investors seeking steady growth in their capital over the long term a more straightforward approach might make sense.

Funds like Alliance Trust (ATST) offer investors a carefully-balanced portfolio, which targets an active return from the best companies available across global stock markets. By avoiding overweights or underweights to any single sector, country, region or investment style, Alliance Trust seeks to reduce the risk of investors experiencing losses as a result of unexpected macroeconomic shifts or events – and equally does not look to politics or macroeconomics to drive its portfolio returns.

Instead, returns are driven through the skill of the ten fund managers who each run a 'best ideas' portfolio of their 10-20 most favoured companies, which collectively make up the ATST portfolio.
This approach is grounded in the notion that, over

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the long term, high-quality companies will continue to generally do well regardless of the broader context.

To keep the portfolio balanced in aggregate, Alliance Trust's investment manager Willis Towers Watson, which selects and oversees the trust's underlying portfolios, monitors the overall portfolio's exposure to different regions, sectors and investment styles. While it seeks to keep the trust's exposures close to the MSCI All Country World Index, it does not overengineer it to match that. Instead, where exposures may be veering too far off balance, it will allocate more resources to a portfolio that redresses the balance, as in 2019 when the addition of a fund run by Vulcan Value Partners helped correct some of the trust's US underweight.

Steady Eddie

The potential pitfalls available to investors truly are numerous and unpredictable. While it is possible to invest in a range of funds and to personally take charge of rearranging those funds according to market risks, this approach puts huge responsibility on shoulders which may be ill equipped to deal with it, and can be stressful and time consuming, often without a better result.

Instead, remaining neutral on the direction of macroeconomic events and geopolitics could help investors avoid the perils of market timing. ATST is explicitly designed to do this under its new process and has continued its record of long-term steady outperformance, returning 13.5% annualised on a share price basis over ten years, against a FTSE World TR return of 12.5% annualised over the same period.

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