CASH IS KING AGAIN?

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ROCKHOLD ASSET MANAGEMENT

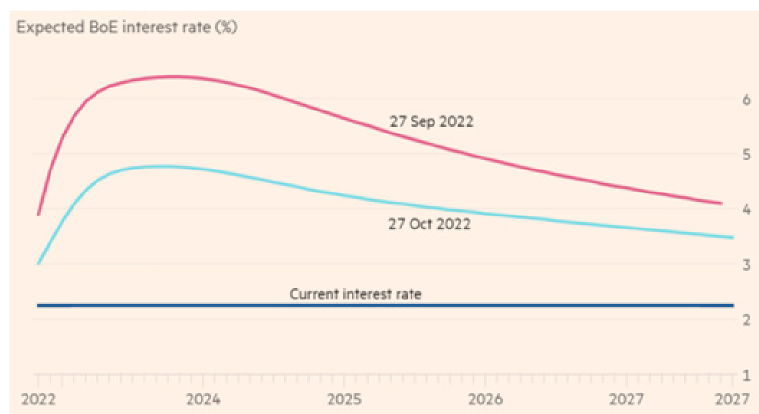
Up until recently, and for well over a decade, advisers have not had to work too hard to convince clients about the long term benefits of an investment based portfolio over keeping money in the bank. Following the Great Financial Crisis of 2008, interest rates were at historically low levels and market portfolios were generating decent returns, so clients weren't generally attracted by the rates offered by banks or building societies.

However, that situation has rapidly changed as interest rates have risen at an unprecedented pace and both equities and bonds have fallen whilst correlating in a way not really witnessed since the 1970's. With fixed term deposit rates of over 4.5% now being offered*, suddenly the 'risk-free' alternative might seem attractive again. So, perhaps we need to start examining and extoling the long-term benefits of equity/bond investing in a way since we really haven't had to do so for a while?

(*Source Moneyfacts.co.uk 31/10/22)

ARE HIGH INTEREST RATES HERE TO STAY?

With government policy currently fluctuating, it's difficult to predict, as the chart below shows. Expectations have slipped since the Truss 'era' in late September, but are still expected to peak at near to 5%. Likewise, the expectation is that they will fall from late 2023. So, it seems likely higher rates than we are used to over the last few years will persist for some time.



Source: BOE 31/10/22

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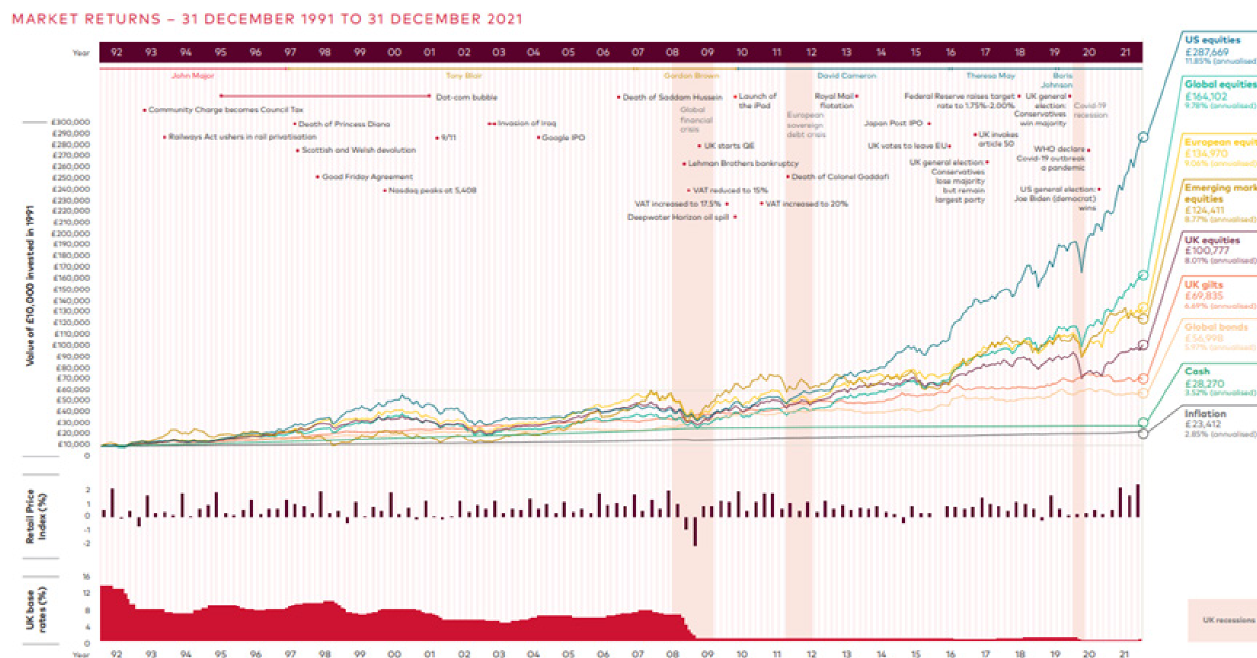
INFLATION ADJUSTED RETURNS

We imagine that every adviser in the country is aware of the implications of higher inflation on cash based investments. However, it's worth reiterating that locking in to a one year 4.5% fixed deposit is effectively locking in a 5.6% loss in real terms, based on an inflation rate of 10.1% (CPI Sept 22. Source ONS)

EQUITIES AND BONDS V CASH

The chart on the right alone should help to convince investors of the long-term merits of investing in a normally diversified portfolio of equities and bonds. It should also help to demonstrate the negative long-term effect of inflation.



Past performance is not a reliable indicator of future results.

Source: Bloomberg, Factset and Bank of England, as at 31 December 2001.

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 brands – Bloomberg Global Aggregate; European equities – MSCI Europe; UK gilts – ICE BofA.

The value of investments, and the income from them may fall or rise and investors may get back less than they invested.

However, it should be observed that the period shown was a particularly benign period for the normally diversified investor, so is probably a little flattering. The previous 30 years witnessed a period of generally declining interest rates and disinflation, which were unusually beneficial to both bonds and equities. It is unlikely that we will return to this environment again, at least in the short term.

Therefore, our expectations for returns should be lower. However, whilst the numbers might be different in the future, there is every argument to suggest that our normally diversified portfolio will outperform cash, especially following the price correction over the last year.

Indeed, in their latest review*, Vanguard's Capital Markets Model is now projecting a 6.8% annual return over ten years for a 60/40 equity/bond portfolio, which is an increase of 3.5% over the Dec 21 projection of 3.3%, when markets as a whole were considerably higher. Whilst this is only a single firm's projection, it is undoubtably a significant predicted improvement.

(*Source: Vanguard's Life Strategy Quarterly review 30 Sept 22)

Looking at our up-to-date asset class return quilt, the breadth of declines across most asset classes is plain to see. It would also suggest that it is risk-based, not risk-free assets, where the opportunities lie.

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Annualised
U.S. equities 32.6%	REITs 22.8%	Japan equities 9.9%	High yield 14.3%	China equities 54.3%	Cash 1.9%	U.S. equities 31.6%	China equities 29.7%	Commodities 38.5%	Commodities 16.6%	U.S. equities 11.7%
Japan equities 27.3%	U.S. equities 13.4%	U.S. equities 1.3%	Infrastructure 12.4%	EM equities 37.8%	DM gov. debt -0.4%	Infrastructure 27%	U.S. equities 21.4%	REITs 32.5%	Cash 0.4%	Infrastructure 5.7%
Europe equities 26%	Infrastructure 13%	Emerging debt 1.2%	U.S. equities 11.6%	Europe equities 26.2%	IG credit -3.5%	Europe equities 24.6%	EM equities 18.7%	U.S. equities 27%	Infrastructure -10.1%	Japan equities 5.2%
Infrastructure 15%	China equities 8.3%	REITs 0.6%	EM equities 11.6%	Japan equities 24.4%	High yield -4.1%	REITs 24.5%	Japan equities 14.9%	Europe equities 17%	High yield -19.1%	REITs 4.7%
High yield 7.3%	Emerging debt 5.5%	Cash 0.1%	Emerging debt 10.2%	U.S. equities 21.9%	U.S. equities -4.5%	China equities 23.7%	IG credit 10.1%	Infrastructure 11.9%	IG credit -20.5%	Europe equities 4.1%
China equities 4%	IG credit 2.5%	Europe equities -2.3%	Commodities 9.7%	Infrastructure 20.1%	Emerging debt -4.6%	Japan equities 20.1%	DM gov. debt 9.5%	Japan equities 2%	DM gov. debt -21.3%	High yield 2.7%
REITs 2.8%	Cash 0.1%	High yield -2.7%	REITs 6.9%	High yield 10.4%	REITs -4.8%	EM equities 18.9%	High yield 7%	High yield 1%	Emerging debt -22.2%	China equities 2.6%
IG credit 1.8%	High yield 0%	DM gov. debt -3.3%	IG credit 6%	Emerging debt 9.3%	Infrastructure -9.5%	Emerging debt 14.4%	Europe equities 5.9%	Cash 0%	U.S. equities -24.8%	EM equities 1.4%
Cash 0.1%	DM gov. debt -0.8%	IG credit -3.8%	Japan equities 2.7%	IG credit 9.3%	Commodities -10.7%	High yield 12.6%	Emerging debt 5.9%	Emerging debt -1.5%	Japan equities -26.1%	Emerging debt 1%
EM equities -2.3%	EM equities -1.8%	China equities -7.6%	DM gov. debt 1.7%	REITs 8.6%	Japan equities -12.6%	IG credit 11.8%	Cash 0.7%	IG credit -2.1%	EM equities -26.9%	IG credit 1%
DM gov. debt -4.3%	Japan equities -3.7%	Infrastructure -11.5%	China equities 1.1%	DM gov. debt 7.3%	EM equities -14.2%	Commodities 11.8%	Infrastructure -5.8%	EM equities -2.2%	Europe equities -28.4%	Cash 0.7%
Commodities -5%	Europe equities -5.7%	EM equities -14.6%	Cash 0.4%	Commodities 1.7%	Europe equities -14.3%	DM gov. debt 5.6%	REITs -8.1%	DM gov. debt -6.6%	REITs -28.7%	Commodities -0.7%
Emerging debt -6.6%	Commodities -17.9%	Commodities -23.4%	Europe equities 0.2%	Cash 0.8%	China equities -18.7%	Cash 2.3%	Commodities -9.3%	China equities -21.6%	China equities -31.1%	DM gov. debt -1.8%

Key: Equities | Bonds | Private markets, commodities

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, 3 October 2022

Rockhold Investment Team November 2022

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