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Three lessons from a roller coaster year

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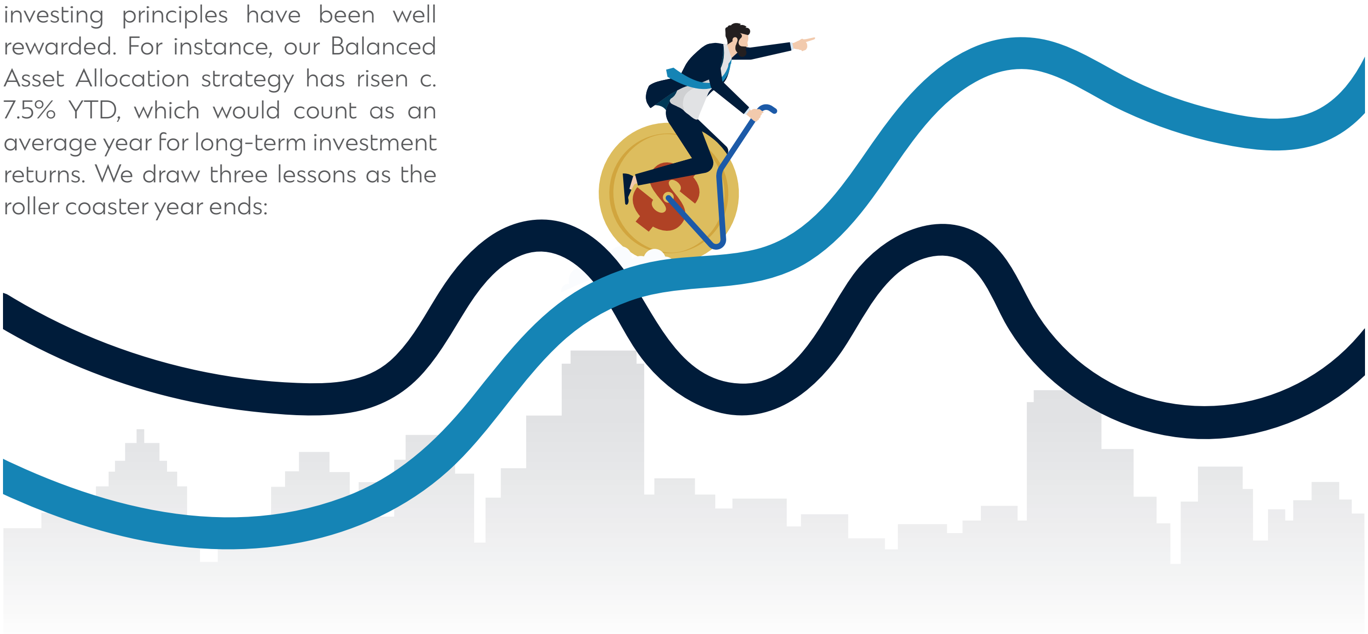
2023 has been a turbulent year for investors. We started the year with widespread pessimism across markets in anticipation of recessions in the US and Europe. We end the year with US and European equity markets approaching all-time highs in anticipation their economies will avoid a recession and achieve a soft-landing. Meanwhile, sentiment around China has turned half circle, from optimism at the start of the year to a pervasive mood of doom and gloom. At face value, the vagaries of the market may seem daunting. However, those who followed some of the time-tested investing principles have been well rewarded. For instance, our Balanced Asset Allocation strategy has risen c. 7.5% YTD, which would count as an average year for long-term investment returns. We draw three lessons as the roller coaster year ends:

Stay invested: This is the cardinal rule of preserving and growing wealth. Allocating broadly to a foundation portfolio consisting of stocks, bonds and alternative assets, and rebalancing periodically has historically helped seasoned investors beat cash returns and inflation. Those who sold all their equity holdings at the start of the year on worries about an impending recession and moved entirely to the "safety" of Developed Market government bonds made only 3% gain, which fell short of even inflation across major markets. Historically, equities outperform a basic diversified allocation on average 7 out of 10 years. Hence, investors need to hold a sizable chunk of their allocation in equities, based on their risk tolerance, to achieve their financial goals over a longer period.

Stay nimble and opportunistic: Staying invested does not mean maintaining the same allocation through market cycles. Maintaining a diversified foundation allocation allows an investor to tactically tweak on the margins to generate any excess returns (the so-called alpha).

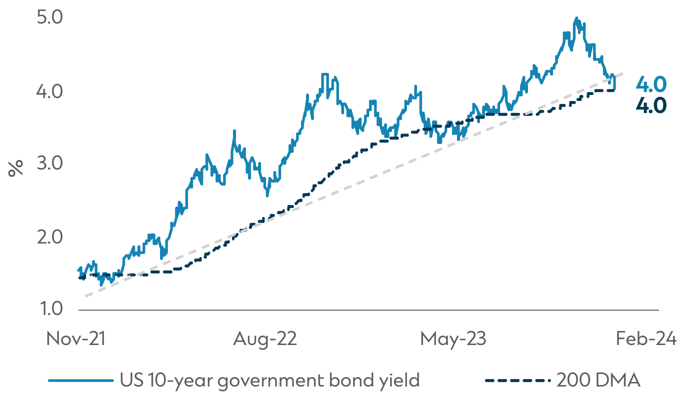


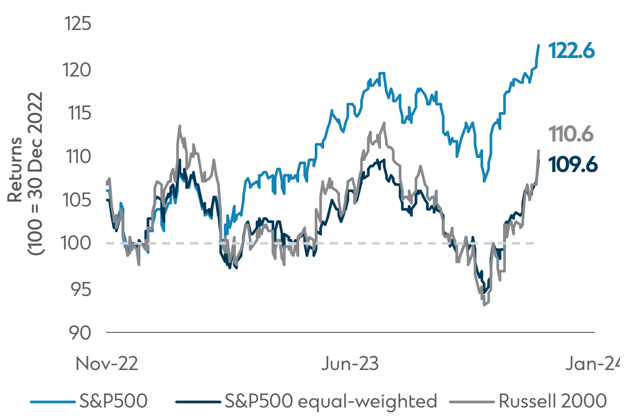
2023 gave investors ample opportunities to benefit from such tactical shifts. Timing the market to perfection over a sustained period is difficult, even for seasoned professionals. However, as our record of generating positive average annual alpha over the past six years shows, there is scope to generate excess returns over and above a basic diversified allocation over the long term.

Besides tactical shifts in the foundation allocation, investors can also benefit from shorter-term opportunistic investments. As the US stock market chart above shows, the S&P500 nominal index significantly outperformed the S&P500 equal-weighted index and the Russell 2000 index of small cap stocks in 2023. This outperformance was driven by large cap technology- and communications services-related firms. Thus, picking the right equity sectors would have helped generate additional alpha this year. That said, it would be prudent to limit opportunistic investments within one's risk tolerance.

Stay calm and disciplined: Ignoring market mood swings and staying disciplined is one of the cornerstones of a successful investment strategy. This has a contrarian streak to it. We started the year with a pervasive mood of pessimism. The downbeat consensus made it easier for risk assets, albeit led by a narrow group of stocks (such as the "Magnificent Seven" in the US, riding on the Artificial Intelligence wave), to climb the wall of worry in H1. Then, over-exuberance met with a resurgence in government bond yields, leading to a sharp pullback in stocks and bonds in Q3. However, both stocks and bonds have rebounded strongly as we head towards the year end. Markets are now expecting the US and Europe to avoid recessions and achieve the so-called soft-landing. This 'Goldilocks' scenario involves inflation continuing to cool, without a significant rise in joblessness, enabling central banks to cut rates early enough to avoid a recession. It is a narrow window, which leaves little room for policy mistakes and significant scope for volatility in the coming year. Hence, besides indications of any sharp economic downturn, investors will need to watch investor positioning across markets closely for any sign of overexuberance as that could be a contrarian signal for a likely turn in markets.

Bond and equity markets have had a choppy ride in recent years





Source: Bloomberg, Standard Chartered

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