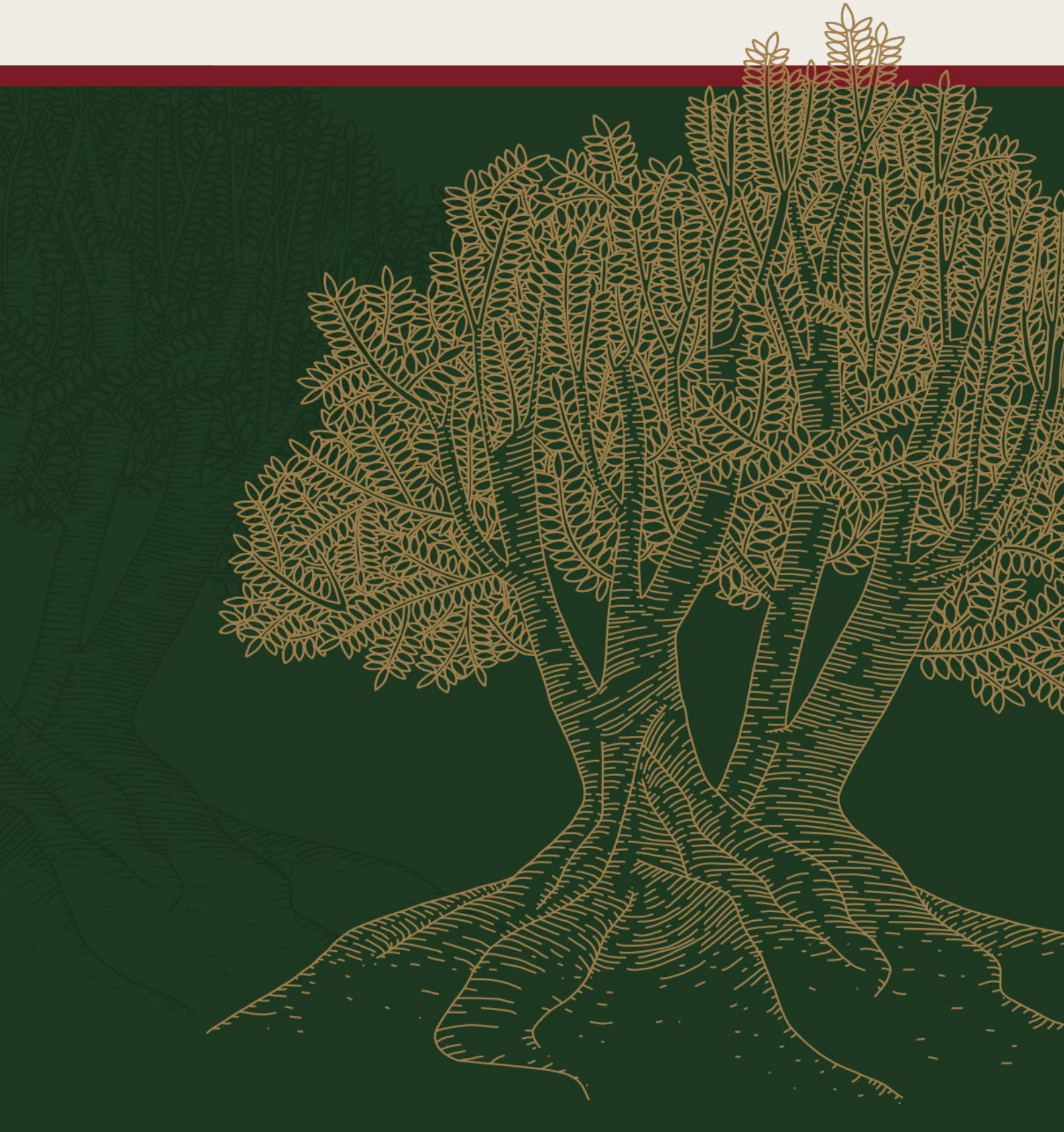
OMBA
ADVISORY & INVESTMENTS

# HOLDING THE COURSE:

## REMAINING INVESTED IN TIMES OF UNCERTAINTY

September 2021



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# INVESTORS ARE ALWAYS NERVOUS

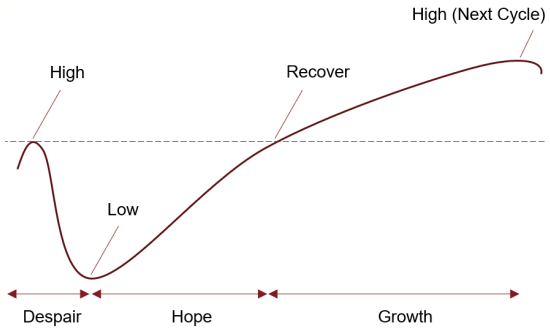
## INTRODUCTION

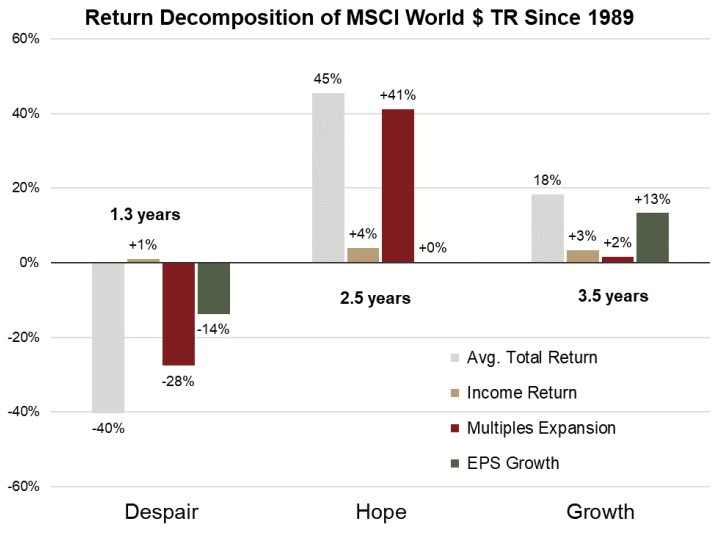
As investment managers, bridging the worlds between institutional investors and non-institutional clients, we often need to dissect markets at varying levels of detail. Investing well in today's data-dependent world requires complex analysis. Effective communication sometimes requires simplification.

Whilst Omba specialises in the day-to-day nuances of financial markets, the following publication uses historical data to justify some conventional wisdoms of investing that anyone can use. We cover broadly applicable concepts that non-institutional clients can rely on when making their overall balance-sheet allocation considerations. While our day to day business is in the details, our clients first need to feel comfortable with the decision to put their money to work and keep it at work. **The motivation of this publication is to illuminate the "why" behind the "what" of some of the broadest rules of investing. We then take a deeper dive into the inter-related concepts of equity returns and inflation which is front-and-centre of many discussions we're having with investors.**

## IS THERE EVER A PERFECT TIME TO INVEST?

**There is never a perfect time to invest. Although investors are always nervous, there is usually a good reason to be.** Below we dissect a market cycle by splitting it into sequential Phases and highlight some characteristics and challenges associated with each stage. We define a normal market cycle by the "Despair", "Hope", and "Growth" Phases. As per the chart on the right, the different Phases are dictated by a total return index, which move from the "High" to "Low" to "Recovery" to the next "High" point.




*All returns are annualised.* *Source:Omba calculations, Datastream*

We use the markets "Phases" framework throughout this publication to draw patterns over a cycle, including the average duration of each Phase and what drives the return performance. The graph on the left decomposes the drivers of total returns of the MSCI World in US dollars. Performance data is annualised (rebased to 1-year) and averaged across each Phase occurance since 1989 using monthly data[1].

## DESPAIR

**The Phase ranging from the High to Low point: the average duration being 1.3 years with a 40% drawdown.** Although earnings-per-share (EPS) growth contracts, meaning that companies make less money during a market downturn, the larger driver of negative returns comes from "multiples contraction"[1]. Income, in the form of dividends, will never turn negative but will be smallest during the Despair Phase when dividends are often cut.

*Investors fear "buying the dip" due to elevated uncertainty, reduced risk appetite given recent losses, and an overwhelmingly negative news narrative. Although the Low point is the best time to buy, it is often hard for investors to take more risk in this environment.*

## HOPE

**The Phase ranging from Low to Recover point: the average duration being 2.5 years with a 45% recovery.** The Hope Phase is named as such because the primary driver of returns is multiples expansion, or increased risk taking. Whilst investors are willing to pay a premium for equity exposure, it is the rotation into risky assets that drives the positive returns as opposed to fundamental earnings growth. EPS growth, which indicates fundamental economic growth for companies, is negligible given the forward-looking approach that investors have for risk taking.

*After the quick and large initial bounce, investors are often side-lined by the challenge of reconciling higher prices with a still-muted economic fundamentals. "If only I had bought sooner"! Often, due to recency biases, a negative narrative remains front-of-mind and hence investors wonder if this nascent recovery is overdone (or if there will be a "double dip"). Higher prices and weak fundamentals make it difficult for investors to take more risk.*

## GROWTH

**The Phase ranging from Recover to New High point: the average duration being 3.5 years with 18% growth.** The bulk of the real economic growth occurs over the aptly-named Growth Phase. It is the most protracted Phase and returns are primarily driven by earnings growth and not multiples expansion (i.e. increased risk taking). Stock prices break fresh all-time highs as businesses expand relative to the previous business cycle.

*Growth is a slow grind higher and isn't as swift as the Hope Phase, which can easily fatigue investors. The combination of an "ageing bull market" narrative and all-time high prices often dissuade investors; especially those with valuation concerns. "We've already seen most of the gains!", whilst true, if not now then when?*

[1] "Multiples" refers to equity valuation metrics such as price-to-earnings (P/E) ratios. The term "multiple" is implied by the ratio, or multiple, of how many dollars and investor is willing to pay (i.e. Price) per dollar of earnings. Contracting multiples means that investors are willing to pay fewer dollars per dollar of earnings (risk aversion) whereas expanding multiples means that investors are willing to pay more dollars per dollar of earnings (increased risk taking).

**There are always valid reasons for investor nervousness.** Financial markets, per some definitions[2], are even more difficult to predict than the weather. Given the myriad of challenges of investing, not limited to an inexhaustible list of cognitive biases and an excess of ever-changing news, we provide a few touchpoints that can be used in holistic asset allocation at any point of the cycle.

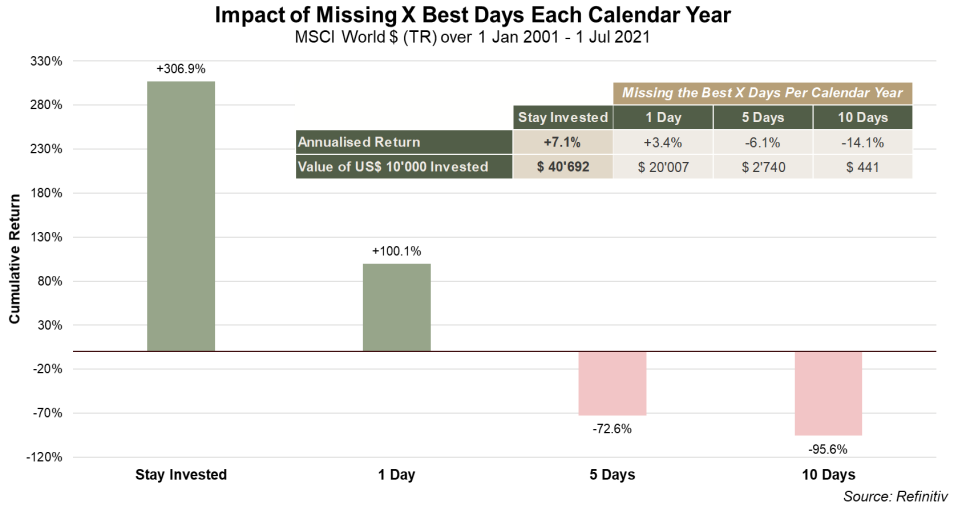
# A FEW CONVENTIONAL WISDOMS

## "TIME IN THE MARKET, NOT TIMING THE MARKET"

**Bottom line: stay invested! Nobody knows when markets will hit the Low and the best daily performance typically occurs near the trough.**

The chart below depicts the impact of missing only a few of the best days in each calendar year between 1 January 2001 and 1 July 2021 for an investment in the MSCI World Index (total returns in US dollars). This period was chosen because it uses the earliest date at which daily total return data is available.

- Missing the **single best day** each calendar year would more than halve your investment return (annualised average).
- Missing the **single best day** each calendar year over the period would cost you over 200% (cumulative) in foregone gains.
- Missing the **best 10 days** each calendar year would leave you with less than 5% of your initial investment (cumulative) – nearly a complete loss.

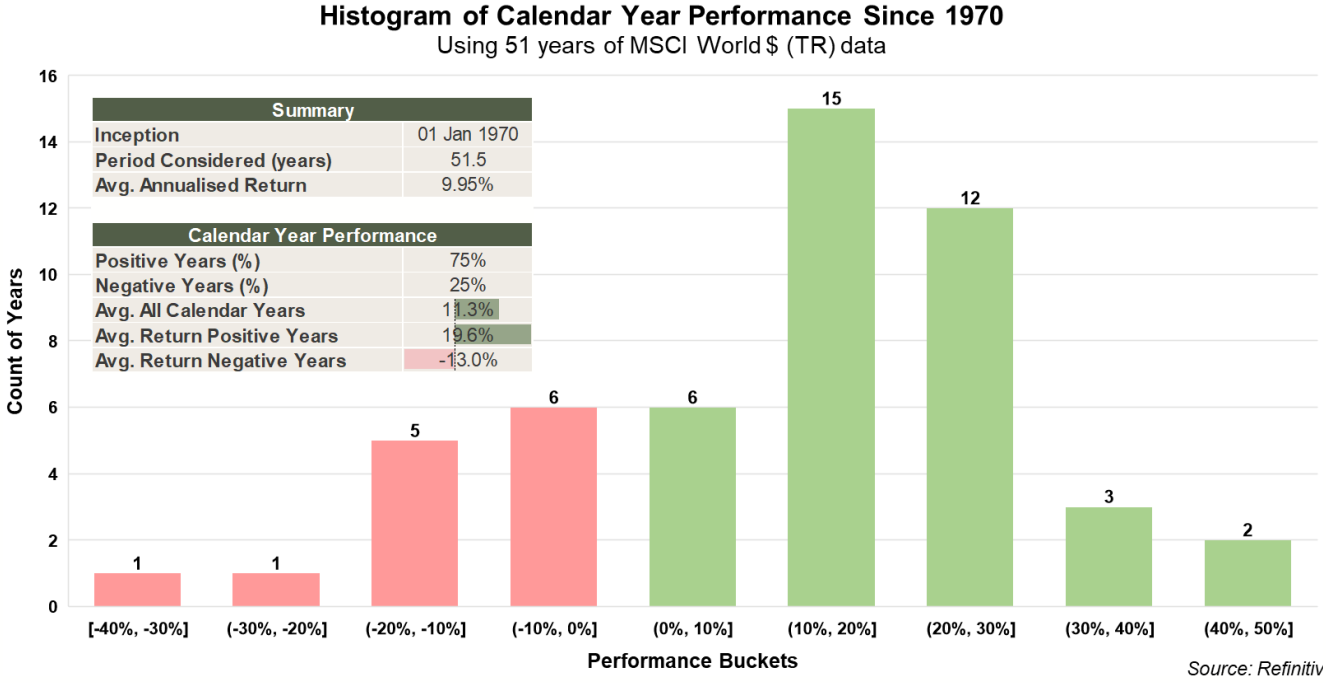



[2] In "Sapiens: A Brief History of Humankind", Yuval Noah Harari describes first and second order chaotic systems. Weather can be described as first order chaotic: a chaotic system with no intelligence. Financial markets, on the other hand, are a second order chaotic system: one that responds to predictions. Despite all its difficulty, a meteorologists' forecast of the future does nothing to impact the predicted outcome. Financial markets however, in all their cunning and genius, are affected by forecasts (i.e. predictions of chaotic systems) as investors reinforce, monopolise, or exploit any new information. How investors respond to price, economic, or even environmental forecasts thus sometimes change financial markets in such a way that compromises the very premise of the initial forecast. A buying opportunity, that everyone agrees upon, may soon turn into a bubble (or a selling opportunity). We will leave the complexities of human cognitive biases unspoken.

## "IT PAYS TO BE DEPLOYED"

**Bottom line: long-term data suggests that investments in global equities have taken 7.3 years to double on average[3]. Equities mostly go up and rise by a greater magnitude than when they fall.**

- The below chart shows the long-term historic performance of global equities. Markets have gone up 75% of calendar years since 1970.
- For positive calendar years, global equities rose 19.6% on average. Negative years saw a 13% fall on average.




*Source: Refinitiv*

## "EXCESS LIQUIDITY": CAPITAL AT RISK OVER A MARKET CYCLE

**Bottom line: know your "excess liquidity" (i.e. capital at risk that won't be needed over the next 3 to 5 years).**

**We all want our wealth to grow, especially at a rate greater than inflation. Unfortunately, return entails taking risk and investing more than one can afford might mean needing to crystalise a loss (selling at the Lows) in order to raise capital for liquidity needs.** Hence, it is important to know how much risk (and what kind of risk) is appropriate for an individual. Prudent allocating partly means that (i) one understands how much capital they are able to responsibly invest in the context of their personal balance sheet and (ii) deploying capital in risk-appropriate securities.

- Our general rule of thumb is that any capital not needed over the next 3 to 5 years (e.g. the cost of buying a property, general living costs) can be fully deployed into risky assets. We call this "excess liquidity".
- "Excess liquidity" is referred to as such because it won't be needed for liquidity reasons over a relatively short time horizon i.e. it can stay invested, even if the underlying assets are liquid themselves (like funds, liquid stocks, or ETFs).

[3] The 7.3 years figure is based on the average annualised return of 9.95%. Alternatively, the "Rule of 72" is a simple estimate of the number of years needed to double an investment. It is calculated by dividing 72 by the annualised rate of return e.g. 72/9.95 = 7.24 [years] – ***online calculator***

- From the table below, which looks at the MSCI World Index ($ TR) drawdowns in excess of 15% since 1970, we find the average High-to-Low-to-Recover duration is 3 years. To be more prudent one can add 2 years for a greater margin of safety.
- Hence, data suggests that a 5 year outlook is generally adequate to ensure that your capital will fully recover (from intra-cycle drawdowns) or be worth more due to markets trending higher.
- Further details of the examined market cycles[2] can be found in the Appendix.

| MSCI World $ (TR) Drawdowns since 1970 (>15.0% fall) | |
|---|---|
| Count of >15.0% Drawdowns | 8 |
| Avg. Drawdown Duration in Years (High-to-Low) | ***1.1*** |
| Avg. Recovery Duration in Years (Low-to-Recover) | ***1.9*** |
| Avg. Duration of New Highs in Years (Recover-to-High) | 3.4 |
| Avg. Length of Market Cycle in Years (High-to-High) | 6.4 |

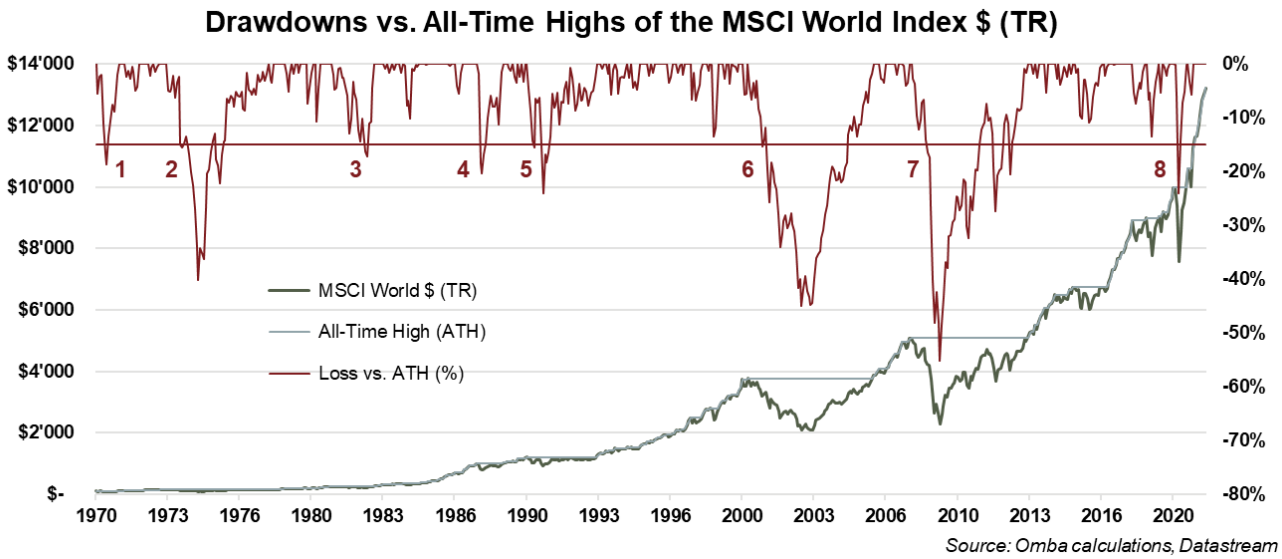
***Excess Liquidity: 3 years average "High-to-Low-to-Recover" duration plus 2 years margin for safety***

| Return Profile | |
|---|---|
| Avg. Drawdown (High vs. Low) | -30.5% |
| Avg. Excess New High (Recover vs. High) | 97.3% |

***Quick bounces vs. "time in the market":*** *Market* ***Recoveries*** *occur quicker than* ***New High*** *periods (usually "slow grinds higher") but* ***New High*** *periods generate the new profit.*

*Source: Refinitiv*

- The chart below shows all MSCI World $ (TR) drawdowns relative to its own All-Time Highs (ATH). It also shows the 8 market Phases over which drawdowns, using month end data, exceeded 15% (and made full recoveries/broke new All-Time Highs before correcting again).




*Source: Omba calculations, Datastream*

## "MOSTLY EQUITIES"

**Bottom line: your "excess liquidity" should mostly be held in equities. Equities outperform bonds, commodities, and cash over the long-term.**

- Equities offer the best return profile and can be highly liquid.
- Equity markets are easy to *benchmark* (i.e. an investible and transparent alternative exists). The use of a benchmark helps one better understand decision making and risks (detailed **later**).

| Asset Class | Average Annual Return (2001-2020) |
|---|---|
| MSCI World $ TR | 8.4% |
| Multi-asset Portfolios | 6.7% |
| Global Bonds | 4.8% |
| Cash | 1.4% |
| Commodities | -0.6% |

*Optimal allocating implies that **Excess Liquidity** is deployed according to the best risk/return profile.*

*Source: Refinitiv, MFS*

## "MOSTLY DIVERSIFIED"

**Bottom line: diversified strategies pay. Due to the high degree of return dispersion, active strategies can be appropriate when done by experts. Regional and sectoral performance is erratic and somewhat unpredictable.**

- The table below shows, due to GICS sector return dispersion from 1995-2020, only 4 of 11 GICS sectors actually beat the broad benchmark (MSCI World $ TR Index). Hence, a diversified approach is a good starting point for individual investors.

| Period Metric | MSCI World | Comm's Services | Cons. Discret. | Cons. Staples | Energy | Financial | Health Care | Indust. | Tech | Material | Utilities |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Annualised Return | +8.2% | +6.8% | +9.1% | +9.7% | +6.4% | +5.6% | +11.3% | +7.6% | +12.1% | +6.9% | +7.6% |
| Difference to MSCI World | +0.0% | -1.4% | +0.9% | +1.5% | -1.8% | -2.6% | +3.1% | -0.7% | +3.9% | -1.3% | -0.7% |

***Only 4 of 11 sectors outperformed the MSCI World $ TR Index over the period 1995-2020.*** *Sector performance differs vastly over time and is unpredictable. All listed sectors are MSCI World $ TR sector indices (i.e. GICS sector carve-outs of the MSCI World Index). Real Estate was excluded as index data was only available from 2016.*

*Source: Omba calculations, Refinitiv*

- The grid below shows the inconsistent nature of sectoral performance. The average calendar year return dispersion (best vs. worst) was 40%, ranging from 20% to 116%, over 1995-2020. Sector performance changes over the market cycle and is somewhat unpredictable.

***The bottom row shows the difference between the best and worst performing MSCI World GICS sector for each calendar year (all $ TR).***

| 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Health +47.7% | Tech +28.8% | Health +37.6% | Tech +68.8% | Tech +100.2% | Health +27.0% | Material - 4.5% | Staples - 2.7% | Tech +48.5% | Utilities +29.5% | Energy +29.4% | Utilities +36.9% | Material +33.8% | Health - 21.1% | Material +62.2% | Discret. +25.0% | Health +10.2% | Financial +30.1% | Discret. +39.8% | Health +18.7% | Staples +7.1% | Energy +27.6% | Tech +38.7% | Health +3.0% | Tech +48.2% | Tech +44.3% |
| Tech +31.4% | Energy +25.6% | Comm's +25.3% | Comm's +52.8% | Comm's +44.7% | Utilities +23.1% | Energy - 6.8% | Material - 4.1% | Material +45.8% | Energy +28.8% | Material +19.8% | Comm's +32.9% | Energy +30.4% | Staples - 22.8% | Tech +52.9% | Indust. +23.9% | Staples +9.3% | Discret. +24.9% | Health +37.1% | Tech +16.6% | Health +7.1% | Material +23.0% | Material +29.5% | Utilities +2.9% | Indust. +28.5% | Discret. +37.0% |
| Staples +27.9% | Health +21.8% | Staples +24.9% | Health +36.8% | Discret. +33.0% | Staples +11.3% | Staples - 7.9% | Energy - 5.9% | Financial +39.7% | Indust. +19.8% | Utilities +13.9% | Material +29.3% | Utilities +22.3% | Utilities - 28.8% | Discret. +40.2% | Material +21.6% | Comm's +1.9% | Health +18.4% | Indust. +32.8% | Utilities +16.2% | Discret. +5.9% | Indust. +13.6% | Indust. +25.9% | Tech - 2.3% | MSCI World +28.4% | Comm's +23.4% |
| Comm's +26.5% | Staples +21.3% | Tech +23.3% | Discret. +25.9% | Material +28.8% | Financial +10.6% | Discret. - 10.0% | Utilities - 15.4% | Indust. +38.8% | Material +18.2% | Indust. +12.5% | Financial +24.5% | Comm's +22.3% | Comm's - 32.3% | Financial +31.8% | Staples +13.4% | Energy +0.7% | Indust. +16.7% | Comm's +32.4% | Staples +8.0% | Tech +5.2% | Financial +13.2% | Discret. +24.2% | Discret. - 5.1% | Comm's +27.9% | Material +20.5% |
| Energy +25.6% | MSCI World +14.0% | Energy +20.4% | MSCI World +24.8% | Indust. +27.6% | Energy +6.5% | Health - 13.0% | Financial - 15.9% | Discret. +37.7% | Financial +18.1% | Financial +12.1% | Discret. +21.2% | Staples +18.9% | Energy - 37.7% | MSCI World +30.8% | Energy +12.5% | Tech - 2.2% | MSCI World +16.5% | Tech +29.3% | MSCI World +5.5% | Comm's +3.4% | Tech +12.0% | Financial +23.4% | MSCI World - 8.2% | Discret. +27.1% | MSCI World +16.5% |
| Financial +23.4% | Discret. +13.7% | Financial +19.5% | Utilities +24.6% | MSCI World +25.3% | Indust. - 1.3% | Indust. - 15.4% | Health - 17.7% | MSCI World +33.8% | Comm's +18.1% | MSCI World +10.0% | Staples +20.8% | Indust. +15.8% | MSCI World - 40.3% | Indust. +27.6% | MSCI World +12.3% | Utilities - 2.3% | Staples +14.2% | Financial +28.0% | Discret. +4.4% | MSCI World - 0.3% | MSCI World +8.2% | MSCI World +23.1% | Comm's - 9.1% | Financial +26.4% | Health +14.1% |
| MSCI World +21.3% | Utilities +9.5% | MSCI World +16.2% | Staples +22.6% | Energy +22.7% | Material - 12.9% | Financial - 16.5% | MSCI World - 19.5% | Utilities +29.3% | MSCI World +15.2% | Health +9.4% | MSCI World +20.7% | Tech +15.3% | Discret. - 41.4% | Energy +27.0% | Comm's +11.4% | Discret. - 4.3% | Tech +13.8% | MSCI World +27.4% | Financial +3.7% | Indust. - 1.5% | Utilities +6.9% | Health +20.4% | Staples - 9.5% | Material +23.9% | Indust. +12.2% |
| Utilities +19.0% | Indust. +8.9% | Utilities +14.4% | Financial +13.0% | Financial +8.6% | MSCI World - 12.9% | MSCI World - 16.5% | Indust. - 22.1% | Energy +26.7% | Discret. +15.2% | Staples +6.3% | Indust. +19.1% | MSCI World +9.6% | Indust. - 42.7% | Staples +22.5% | Tech +10.8% | MSCI World - 5.0% | Material +11.8% | Staples +22.0% | Indust. +1.0% | Financial - 2.9% | Comm's +6.6% | Staples +17.8% | Indust. - 14.1% | Health +23.9% | Staples +8.5% |
| Indust. +13.5% | Comm's +8.8% | Discret. +9.1% | Indust. +7.9% | Health - 10.1% | Discret. - 23.4% | Utilities - 21.9% | Discret. - 22.3% | Comm's +26.0% | Staples +12.4% | Tech +5.0% | Energy +18.4% | Health +4.4% | Tech - 43.7% | Health +19.7% | Financial +5.1% | Indust. - 7.7% | Comm's +7.6% | Energy +18.8% | Comm's - 1.1% | Utilities - 5.8% | Discret. +3.6% | Utilities +14.6% | Energy - 15.2% | Staples +23.6% | Utilities +5.6% |
| Discret. +12.7% | Financial +8.5% | Indust. +2.3% | Energy +4.9% | Utilities - 12.2% | Comm's - 40.9% | Comm's - 25.2% | Comm's - 28.5% | Health +20.0% | Health +6.4% | Discret. +1.5% | Health +10.9% | Discret. - 2.9% | Material - 49.8% | Comm's +15.0% | Health +3.0% | Financial - 18.1% | Utilities +2.9% | Utilities +13.7% | Material - 4.6% | Material - 14.9% | Staples +2.3% | Comm's +6.7% | Financial - 16.5% | Utilities +23.6% | Financial - 2.2% |
| Material +7.1% | Material +7.7% | Material - 9.7% | Material +0.3% | Staples - 15.7% | Tech - 41.7% | Tech - 29.5% | Tech - 38.6% | Staples +17.5% | Tech +2.6% | Comm's - 9.2% | Tech +9.5% | Financial - 7.7% | Financial - 53.6% | Utilities +7.4% | Utilities +0.0% | Material - 19.6% | Energy +2.5% | Material +3.9% | Energy - 11.0% | Energy - 22.2% | Health - 6.3% | Energy +5.9% | Material - 16.6% | Energy +12.5% | Energy - 30.5% |
| ***41%*** | ***21%*** | ***47%*** | ***68%*** | ***116%*** | ***69%*** | ***25%*** | ***36%*** | ***31%*** | ***27%*** | ***39%*** | ***27%*** | ***41%*** | ***33%*** | ***55%*** | ***25%*** | ***30%*** | ***28%*** | ***36%*** | ***30%*** | ***29%*** | ***34%*** | ***33%*** | ***20%*** | ***36%*** | ***75%*** |

*Source: Omba calculations, Refinitiv*

- Similarly, as the tables below show, regional performance also varies over time with return dispersion (best vs. worst) averaging 34% each calendar year from 1988-2020 (when data began). Interestingly, higher risk regions such as Latin America and Emerging Markets beat the broader benchmark (MSCI World $ TR Index) - although this comes with higher volatility and longer required holding periods.

| Period Metric | MSCI ACWI | MSCI World | MSCI North America | MSCI Latin America | MSCI Europe | MSCI Asia Pacific | MSCI EM |
|---|---|---|---|---|---|---|---|
| Annualised Return | +8.3% | +8.3% | +11.0% | +13.7% | +8.3% | +4.1% | +10.9% |
| Difference to MSCI World | +0.0% | +0.0% | +2.7% | +5.4% | -0.0% | -4.2% | +2.6% |

*Source: Omba calculations, Refinitiv*

*The bottom row shows the difference between the best and worst performing MSCI regional benchmark for each calendar year (all $ TR).*

| 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| MSCI Lat. Am. +80.1% | MSCI EM +65.0% | MSCI North America - 2.9% | MSCI Lat. Am. +149.7% | MSCI Lat. Am. +13.4% | MSCI EM +74.8% | MSCI APAC +11.6% | MSCI North America +37.1% | MSCI North America +24.3% | MSCI North America +32.9% | MSCI North America +29.0% | MSCI EM +66.4% | MSCI Europe - 8.1% | MSCI Lat. Am - 0.4% | MSCI EM - 6.0% | MSCI Lat. Am. +73.7% | MSCI Lat. Am. +39.6% | MSCI Lat. Am. +50.4% | MSCI Lat. Am. +43.5% | MSCI Lat. Am +50.7% | MSCI North America - 37.8% | MSCI Lat. Am +104.2% | MSCI EM +19.2% | MSCI North America +0.6% | MSCI Europe +19.9% | MSCI North America +30.4% | MSCI North America +12.6% | MSCI North America - 0.3% | MSCI Lat. Am. +31.5% | MSCI EM +37.8% | MSCI North America - 5.2% | MSCI North America +31.5% | MSCI North America +20.6% |
| MSCI EM +40.4% | MSCI Lat. Am. +55.7% | MSCI Europe - 3.4% | MSCI EM +59.9% | MSCI EM +11.4% | MSCI Lat. Am. +53.9% | **MSCI World +6.6%** | MSCI Europe +22.1% | MSCI Lat. Am. +22.2% | MSCI Lat. Am. +31.6% | MSCI Europe +28.9% | MSCI Lat. Am. +58.9% | MSCI North America - 11.8% | MSCI EM - 2.4% | MSCI APAC - 8.3% | MSCI EM +56.3% | MSCI EM +26.0% | MSCI EM +34.5% | MSCI Europe +34.4% | MSCI EM +39.8% | **MSCI World - 40.3%** | MSCI EM +79.0% | MSCI APAC +17.2% | **MSCI World - 5.0%** | MSCI EM +18.6% | **MSCI World +27.4%** | **MSCI World +6.5%** | **MSCI World - 0.3%** | MSCI North America +12.3% | MSCI APAC +32.0% | MSCI Lat. Am. - 6.2% | **MSCI World +28.4%** | MSCI APAC +20.1% |
| MSCI APAC +35.2% | MSCI North America +30.9% | MSCI Lat. Am. - 7.8% | MSCI North America +29.9% | MSCI North America +6.1% | MSCI APAC +38.3% | **MSCI ACWI +5.0%** | **MSCI World +21.3%** | MSCI Europe +21.6% | MSCI Europe +24.2% | **MSCI World +24.8%** | MSCI APAC +58.3% | **MSCI World - 12.9%** | MSCI North America - 12.4% | MSCI Europe - 18.1% | MSCI APAC +40.9% | MSCI Europe +21.4% | MSCI APAC +23.8% | MSCI EM +32.6% | MSCI APAC +14.6% | MSCI APAC - 41.6% | MSCI APAC +37.9% | MSCI North America +16.0% | **MSCI ACWI - 6.9%** | MSCI APAC +17.0% | MSCI Europe +26.0% | **MSCI ACWI +4.7%** | MSCI APAC - 1.7% | MSCI EM +11.6% | MSCI Europe +26.2% | **MSCI World - 8.2%** | **MSCI ACWI +27.3%** | MSCI EM +18.7% |
| **MSCI ACWI +24.0%** | MSCI Europe +29.1% | MSCI EM - 10.6% | **MSCI ACWI +19.9%** | **MSCI ACWI - 4.2%** | MSCI Europe +29.8% | MSCI Europe +2.7% | **MSCI ACWI +19.5%** | **MSCI World +14.0%** | **MSCI World +16.2%** | **MSCI ACWI +22.0%** | **MSCI ACWI +26.8%** | **MSCI ACWI - 13.9%** | **MSCI ACWI - 15.9%** | **MSCI ACWI - 19.0%** | MSCI Europe +39.1% | MSCI APAC +18.6% | **MSCI ACWI +11.4%** | **MSCI ACWI +21.5%** | MSCI Europe +14.4% | **MSCI ACWI - 41.8%** | MSCI Europe +36.8% | MSCI Lat. Am. +14.9% | MSCI Europe - 10.5% | **MSCI ACWI +16.8%** | **MSCI ACWI +23.4%** | MSCI APAC +0.3% | **MSCI ACWI - 1.8%** | **MSCI ACWI +8.5%** | **MSCI ACWI +24.6%** | **MSCI ACWI - 8.9%** | MSCI Europe +24.6% | **MSCI ACWI +16.8%** |
| **MSCI World +24.0%** | **MSCI ACWI +17.6%** | **MSCI ACWI - 16.5%** | **MSCI World +19.0%** | MSCI Europe - 4.2% | **MSCI ACWI +24.9%** | MSCI North America +1.7% | MSCI APAC +2.1% | **MSCI ACWI +13.2%** | **MSCI ACWI +15.0%** | MSCI APAC +2.6% | **MSCI World +25.3%** | MSCI Lat. Am. - 16.6% | **MSCI World - 16.5%** | **MSCI World - 19.5%** | **MSCI ACWI +34.6%** | **MSCI ACWI +15.8%** | **MSCI World +10.0%** | **MSCI World +20.7%** | **MSCI ACWI +12.2%** | MSCI Europe - 46.1% | **MSCI ACWI +35.4%** | **MSCI ACWI +13.2%** | MSCI APAC - 14.9% | **MSCI World +16.5%** | MSCI APAC +12.2% | MSCI EM - 1.8% | MSCI Europe - 2.3% | **MSCI World +8.2%** | MSCI Lat. Am. +24.2% | MSCI APAC - 13.3% | MSCI APAC +19.7% | **MSCI World +16.5%** |
| MSCI Europe +16.4% | **MSCI World +17.2%** | **MSCI World - 16.5%** | MSCI Europe +13.7% | **MSCI World - 4.7%** | **MSCI World +23.1%** | MSCI Lat. Am. +0.6% | MSCI EM - 5.2% | MSCI EM +6.0% | MSCI EM - 11.6% | MSCI EM - 25.3% | MSCI North America +23.5% | MSCI APAC - 28.4% | MSCI Europe - 19.6% | MSCI North America - 22.3% | **MSCI World +33.8%** | **MSCI World +15.2%** | MSCI Europe +9.9% | MSCI APAC +16.8% | **MSCI World +9.6%** | MSCI Lat. Am. - 51.3% | **MSCI World +30.8%** | **MSCI World +12.3%** | MSCI EM - 18.2% | MSCI North America +15.6% | MSCI EM - 2.3% | MSCI Europe - 5.7% | MSCI EM - 14.6% | MSCI APAC +5.2% | **MSCI World +23.1%** | MSCI EM - 14.2% | MSCI EM +18.9% | MSCI Europe +5.9% |
| MSCI North America +16.1% | MSCI APAC +3.1% | MSCI APAC - 34.2% | MSCI APAC +11.5% | MSCI APAC - 17.3% | MSCI North America +10.5% | MSCI EM - 7.3% | MSCI Lat. Am. - 12.8% | MSCI APAC - 8.2% | MSCI APAC - 27.1% | MSCI Lat. Am. - 35.1% | MSCI Europe +16.2% | MSCI EM - 30.6% | MSCI APAC - 20.7% | MSCI Lat. Am. - 22.5% | MSCI North America +30.1% | MSCI North America +11.3% | MSCI North America +6.9% | MSCI North America +15.5% | MSCI North America +7.7% | MSCI EM - 53.2% | MSCI North America +29.3% | MSCI Europe +4.5% | MSCI Lat. Am. - 19.1% | MSCI Lat. Am. +8.9% | MSCI Lat. Am. - 13.2% | MSCI Lat. Am. - 12.0% | MSCI Lat. Am. - 30.8% | MSCI Europe +0.2% | MSCI North America +21.6% | MSCI Europe - 14.3% | MSCI Lat. Am. +17.9% | MSCI Lat. Am. - 13.5% |
| 64% | 62% | 31% | 138% | 31% | 64% | 19% | 50% | 33% | 60% | 64% | 50% | 22% | 20% | 16% | 44% | 28% | 43% | 28% | 43% | 15% | 75% | 15% | 20% | 11% | 44% | 25% | 31% | 31% | 16% | 9% | 14% | 34% |

*Source: Omba calculations, Refinitiv*

## LEAVE ACTIVE DECISIONS TO EXPERTS (MOSTLY)

**Bottom line: active decision making is hard and best left to experts. Trading your retirement fund is as appropriate as doing your own dental work. All deviations from a benchmark are akin to active decision making (or concentration risk). We discuss benchmarks in our publication "*Multi-Asset Portfolios: 10 Questions you should be asking*".**

**There is an asymmetry between the size of a financial loss and the return needed to recover that loss.** The table on the right shows the importance of protecting capital and *good decision making* by demonstrating the detrimental impact of *bad decision making*. A vastly greater return is needed to recover from a loss because a smaller investment "base" needs to work harder to generate a certain dollar value.

It is worth noting even professionals can make investment mistakes (recent examples include Archegos Capital and Woodford Investment Management) and hence ensuring your investment manager(s) adopt a diversified portfolio approach is critical.

| Hypothetical Loss | Return Needed to Recover |
|---|---|
| -5% | +5% |
| -10% | +11% |
| -25% | +33% |
| -50% | +100% |
| -75% | +300% |
| -85% | +567% |

*Source: Omba calculations*

**Non-institutional investors are often surprised by how many decisions they are making without even realising it!** Investment managers are paid to make good decisions. Given the vastness of financial markets and investment opportunities, the first step in decision making is often knowing what the "neutral" position (or no decisions) is. In 1999, MSCI and S&P Dow Jones Indices developed the Global Industry Classification Standard (GICS)[3] which splits equities into 11 mutually exclusive sectors, shown in the table on the right. By having a benchmark (i.e. a passive and investible alternative), such as the MSCI World and the sub-sectors in this table, it is easy for an investor to start looking at their portfolio as a set of active decisions that move them away from (or closer to) a real life benchmark. Once you know what your *implicit decisions* are you can then ask yourself "why am I making these decisions?" and "am I comfortable with these decisions?".

| 11 GICS Sectors | Examples | GICS Weight in MSCI World |
|---|---|---|
| Information Technology | Microsoft | 22.4% |
| Financials | JP Morgan Chase | 13.3% |
| Healthcare | Pfizer | 12.6% |
| Consumer Discretionary | Amazon.com | 12.0% |
| Industrials | Catepillar Inc, Boeing | 10.5% |
| Communication Services | Alphabet, Facebook | 9.1% |
| Consumer Staples | Home Depot | 7.0% |
| Materials | BHP Group | 4.4% |
| Energy | Chevron | 3.0% |
| Utilities | E.ON SE, National Grid | 2.8% |
| Real Estate | Prologis REIT Inc. | 2.7% |

*Source: MSCI, iShares as of 19 July 2021*

**Avoidance biases can also result in Concentration Risk (or active decisions) in the form of "underweight" exposures.** Albeit an extreme example, the below table clearly depits the cost of having excluded exposure to the "growthier" S&P 500 sectors of Technology (e.g. Microsoft, Apple) and Communications Services (e.g. Facebook, Alphabet).

- Exluding these two sectors would have cost 76%-points worth of total return over the considered period.
- This further highlights that concentration risk can exist in both negative ("underweight exposures" from a benchmark) and positive forms ("overweight exposures").
- Non-institutional investors often have strong avoidance biases or familiarity biases. We hope the aforementioned topics illuminate the importance of understanding risks associated with your decisions – even implicit ones.

| Using All Available Data (1 July 2011 - 16 Jul 2021) | | | |
|---|---|---|---|
| Period Metric | S&P 500 (TR) | S&P 500 ex-Tech & Comm's (TR) | *Difference* |
| Cumulative Return | 302% | 226% | *-76%* |
| Annualised Return | 15% | 12% | *-2.4%* |
| US$ 10k Invested | US$ 40.2k | US$ 32.6k | *-US$ 7.6k* |

*The above indicates that for every **US$ 10k invested over the period** the exclusion of Tech and Communications would have **cost US$ 7.6k in profit**, or **76% of the original amount invested**.*

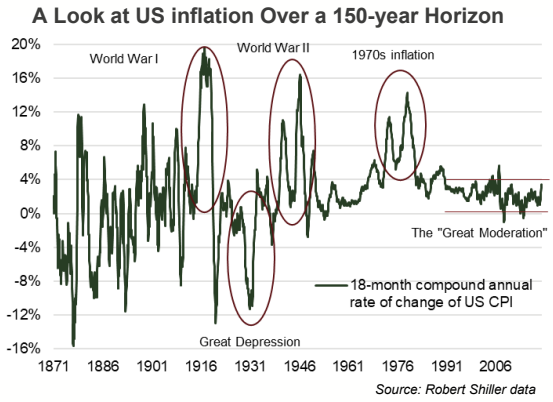
*Source: Refinitiv, S&P Global*

## A FINAL THOUGHT BEFORE INFLATION IS CONSIDERED

If you live in a developed country with good governance, rule of law, and a reasonably stable currency then investing mainly in that country is a reasonably sensible default. One's primary residence and short-term cash savings inevitably do match the country and currency they live in but when there is uncertainty about where you or your heirs might live (and spend) in the future, a global portfolio becomes more sensible. Over the past few decades, globalisation of economic activity and increased integration of capital markets have led to a dramatic expansion of the equity universe for international investors. Institutional investors are able to access a deeper and broader global equity opportunity set. As a result, the "home bias" of some of the world's largest portfolios has declined dramatically since the mid-1990s. Due to the uncertain nature of risky assets, geopolitics, and the future for one's children, Omba believes global equity diversification should be at the core of portfolio construction.

# A NOTE ON INFLATION

## THINKING LONG-TERM




**In our up-coming publication on inflation, we scrutinise the interplay between equities and inflation through a quantitative lens.** Although out of scope of this piece, we do want to highlight the importance of understanding the risks of inflation (and ways to protect against it) over the long-term. The chart on the right shows the long-term history of US inflation, and the "great moderation" since the inflation spike of the 1970s.

- Although investing is risky in the short-term, it is riskier to stay uninvested over the long-term due to inflation.
- Equities provide the best protection over the long-term because earnings grow faster than inflation.
- Although company margins tighten in periods of high inflation, the ability of corporates to adjust prices in response to inflation has allowed corporates to grow earnings faster than inflation over the long-term.
- Precious metals, whilst a great inflation hedge over the short-term, are much less effective than equities over the long-term. This was highlighted *above* and is shown *below*.
- The inter-play of earnings, valuations, and multiples is highly complex and is further discussed in our up-coming publication.

## YOU CANNOT AFFORD TO TAKE THE RISK OF TAKING NO RISK

**In the short term, investing is risky.** The value of your investment can decline and if you do not understand your "*excess liquidity*" you might be forced to sell at relatively low prices.

**However, not investing is arguably even riskier! This is due to the compounding effects of inflation over the long-term.** Equities have proven themselves a better investment than cash or bonds and handily "beaten" inflation. Over the last one hundred years, developed markets have delivered *real* returns of around 5% per year and emerging markets around 4% per year, on average[4].

There is a trade-off between security (preserving your wealth) and growth (gaining access to investments that can potentially increase the value of your wealth). In the short-term, wealth security may be improved by minimising investment risk. However, over the long-term wealth security requires increasing your savings and/or investing in companies growing their earnings.

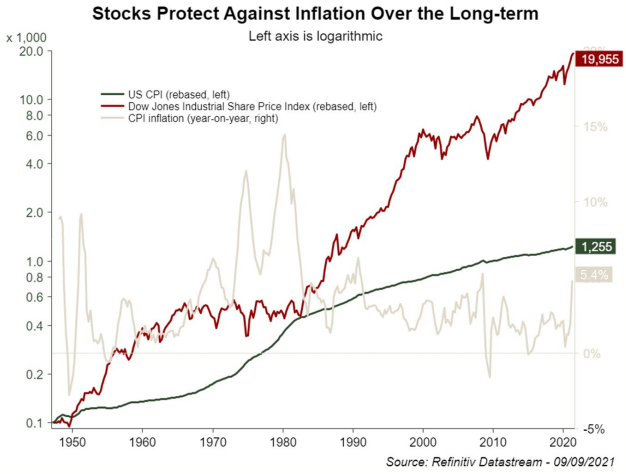
[4] Source: Elroy Dimson, Paul Marsh, Mike Staunton, authors of "Triumph of the Optimists" and Global Investment Returns Yearbook, Credit Suisse, 2021.

## EQUITIES PROTECT WEALTH OVER THE LONG-TERM

**We invest in equities to gain access to the earnings of successful companies.** When we buy shares in a company we become part-owners, entitled to our share of the company's earnings and we receive our share of the dividends paid by the company.

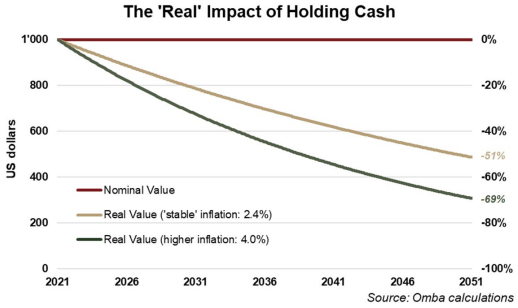
As the chart on the right shows, earnings have grown faster than inflation since 1988, when data began[5]. Earnings growth, alongside multiples expansion due to "secular stagnation" and the secular compression of fixed income yields in Developed Markets, has pushed the S&P 500 higher at a much faster rate than the US CPI inflation basket. Note that gold - although a good hedge against inflation in the short-term - is inferior to equities as a long-term source of return.


As the chart on the left shows, over a longer-term horizon since 1947, equities have strongly outperformed the US CPI inflation basket. Interestingly, over the 1970s inflation scare, the outperformance of US equities versus the US inflation basket narrowed. Over the 1970s, due to loose monetary policy, high oil prices, and labour union power, US CPI inflation reached as high as 14.4% year-on-year. However, despite the recent US inflationary spike (which is negligible compared to the 1970s and 1980s), many levers remain at the US central bank's disposal to quell further overheating. Other sources of inflation, such as energy prices, have likely seen most of their gains and would require exponentially increasing prices of crude oil to keep inflation persistent (due to the "base effect").




## INFLATION AS A RISK TO YOUR WEALTH

**Over thirty years, the *real* value of your savings would likely fall by more than half if kept in cash.** In a scenario of 0.2% inflation per month, or about 2.4% per year, an individual with US$ 1'000 in savings "kept under the mattress" would see the *real* value of their savings decline by more than half to US$ 487 by 2051. In a scenario of 4% inflation per year, the *real* value would decline by more than two thirds to US$ 308. Successful investors know this. They *work hard* to increase their savings and they *invest* to preserve and grow the *real* value of their wealth.




[5] I/B/E/S Datastream, Total Index EPS Earnings for the Calendarised FY0 Fiscal Period

# HOW CAN OMBA HELP YOU?

- We offer access to global capital markets through multi-asset portfolios (using stocks, bonds, and commodities) or globally diversified equity portfolios.
- We provide an active portfolio management process using diversified, readily available products (Exchange Traded Funds).
- We can offer advice on planning for the future, understanding how much excess liquidity you have, understanding how much risk you can afford to take and ought to take (particularly if you have long-term *real* return objectives).
- We always strive to help our clients reduce fees so they achieve better long-term outcomes without excessive costs eating into returns.
- We can perform a health-check of your current investment portfolio, assess your existing providers and make recommendations on what we think is working well and poorly.

# APPENDIX

[1] The below table depicts the historical market Phases upon which the graph is based.

| | | | | | | | | Annualised Data | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Interval | Trajectory | Phase | Length (years) | Total Return | Income | Multiples Expansion | EPS Growth | Total Return | Income | Multiples Expansion | EPS Growth |
| Dec 88 - Jan 90 | Recover - High | Growth | 1.08 | 18% | 2.69% | 11% | 5% | 17% | 2% | 10% | 4% |
| Jan 90 - Oct 90 | High - Low | Despair | 0.75 | -24% | 0.23% | -17% | -7% | -31% | 0% | -22% | -9% |
| Oct 90 - Apr 93 | Low - Recover | Hope | 2.50 | 35% | 9.44% | 32% | -6% | 13% | 4% | 12% | -2% |
| Apr 93 - Apr 00 | Recover - High | Growth | 7.00 | 204% | 40.52% | 39% | 124% | 17% | 5% | 5% | 12% |
| Apr 00 - Mar 03 | High - Low | Despair | 2.92 | -45% | 2.39% | -37% | -10% | -18% | 1% | -15% | -3% |
| Mar 03 - Feb 06 | Low - Recover | Hope | 2.92 | 86% | 11.51% | -3% | 78% | 24% | 4% | -1% | 22% |
| Feb 06 - Nov 07 | Recover - High | Growth | 1.75 | 31% | 5.33% | -2% | 27% | 17% | 3% | -1% | 15% |
| Nov 07 - Mar 09 | High - Low | Despair | 1.33 | -55% | 1.66% | -24% | -33% | -45% | 1% | -19% | -26% |
| Mar 09 - Apr 13 | Low - Recover | Hope | 4.08 | 124% | 24.02% | 22% | 78% | 22% | 5% | 5% | 15% |
| Apr 13 - Jan 20 | Recover - High | Growth | 6.75 | 96% | 30.52% | 28% | 37% | 10% | 4% | 4% | 5% |
| Jan 20 - Apr 20 | High - Low | Despair | 0.25 | -24% | 0.49% | -19% | -5% | -67% | 2% | -58% | -19% |
| Apr 20 - Sep 20 | Low - Recover | Hope | 0.42 | 40% | 1.24% | 54% | -15% | 123% | 3% | 182% | -33% |
| Sep 20 - Jul 21 | Recover - High | Growth | 0.83 | 25% | 1.99% | -7% | 30% | 30% | 2% | -9% | 37% |

*Source: Refinitiv*

[2] Below depicts the 8 drawdowns of the MSCI World ($ TR) since monthly data was available in 1970.

| Month | MSCI World $ (TR) | All-Time High (ATH) | Event Type | Drawdown vs. ATH | Bull Run (% vs. Low) | Months of Bull Run (vs. Low) |
|---|---|---|---|---|---|---|
| Jan 1970 | $100 | $100 | High | | | |
| Jul 1970 | $81 | $100 | Low | -18.6% | | |
| Feb 1971 | $103 | $103 | Recover | | +26.1% | 7 |
| Apr 1973 | $147 | $147 | High | | +80.1% | 33 |
| Oct 1974 | $88 | $147 | Low | -40.1% | | |
| Jan 1978 | $147 | $147 | Recover | | +67.6% | 39 |
| Dec 1980 | $256 | $256 | High | | +191.1% | 74 |
| Aug 1982 | $212 | $256 | Low | -17.2% | | |
| Dec 1982 | $257 | $257 | Recover | | +21.7% | 4 |
| Sep 1987 | $999 | $999 | High | | +372.1% | 61 |
| Dec 1987 | $795 | $999 | Low | -20.4% | | |
| Dec 1988 | $1'019 | $1'019 | Recover | | +28.2% | 12 |
| Jan 1990 | $1'206 | $1'206 | High | | +51.6% | 25 |
| Oct 1990 | $916 | $1'206 | Low | -24.0% | | |
| Apr 1993 | $1'241 | $1'241 | Recover | | +35.5% | 30 |
| Apr 2000 | $3'773 | $3'773 | High | | +311.7% | 114 |
| Mar 2003 | $2'080 | $3'773 | Low | -44.9% | | |
| Feb 2006 | $3'872 | $3'872 | Recover | | +86.2% | 35 |
| Nov 2007 | $5'076 | $5'076 | High | | +144.0% | 56 |
| Mar 2009 | $2'276 | $5'076 | Low | -55.2% | | |
| Apr 2013 | $5'100 | $5'100 | Recover | | +124.1% | 49 |
| Jan 2020 | $9'979 | $9'979 | High | | +338.5% | 130 |
| Apr 2020 | $7'586 | $9'979 | Low | -24.0% | | |
| Sep 2020 | $10'602 | $10'602 | Recover | | +39.8% | 5 |
| Jul 2021 | $13'223 | $13'223 | High | | +74.3% | 15 |

*Source: Omba calculations, Refinitiv*

[3] The Global Industry Classification Standard, MSCI, *https://www.msci.com/gics*