SNAPSHOT

As markets undergo major shifts, we believe it’s more important than ever to take a fresh look at your investments. Ongoing changes in the market can leave you with more risk than you may be comfortable with, or not enough risk to produce the investment returns you need to meet your future goals.

Chris Blum, Head of Global Equities, Global Wealth Management, comments, “For the past few years, markets have been very focused on macro events — or events related to the economy as a whole. We think investors need to look at whether they have the right diversified mix of assets to benefit from an improving global economy where macroeconomic events won’t be such a dominant force.”

Looking ahead, he notes, “We are beginning to see the pillars of sustainable global economic recovery emerge. In particular, we see strong fundamentals in the United States and in emerging markets, while fears over the longer-term future of Europe appear to be subsiding.”

What this means to you

A diversified portfolio today, which includes equities, is going to be key to helping you meet many retirement goals. Equity prices reflect earnings growth, which should be driven higher as the global economy improves. Equities may also provide a level of inflation protection.
Why is fixed income of concern in 2013?

Investments that have worked well until recently may not produce the same level of returns going forward. For example, some parts of the fixed income markets have outperformed equities in recent years, but we believe this is unlikely to be repeated.

“The issue that investors face with certain fixed income instruments, such as core bonds today, is that they are currently offering very low yields, often around 2%,” explains Mr. Blum.

There are two risks associated with that, Mr. Blum notes. “One is that it doesn’t keep up with the rate of inflation. If inflation picks up beyond 2%, you’re going to start to earn negative returns.”

The other risk is if rates start to rise. “There’s an inverse relationship with that and how much you would stand to gain or lose in a particular bond instrument,” says Mr. Blum. If rates on government bonds move from 2% upwards, for example, you can take a loss on the principal that you have invested in that bond. If investors have a large allocation to credit, it might be the right time to consider moving some of this into other risk assets.”

What is the right level of risk in a portfolio?

The right risk allocation for a portfolio depends on a number of factors, including your return expectations, investment objectives, time horizon and risk tolerance. You may have, for example, a 20% allocation to equities or other assets that offer higher returns with more risk. However, to reach your goals in today’s markets, you may need to have closer to a 30% or 40% allocation.

If you aren’t holding the right amount of risk, you may ultimately not realize the gains you are expecting. Of course, you need to be able to withstand the risk and only invest in products that are suitable for you.

Why you may want to consider equities

Mr. Blum comments, “Equities are a good first step if you own too much cash or too many bonds, because stocks tend to behave very differently than bonds. You need to buy an asset class that doesn’t have the same type of correlation or behavior, depending on your profile and suitability requirements.”

While there is no guarantee this will happen, equities seem likely to offer better return possibilities than many other asset classes over the next 12 to 18 months. “We believe they’re going to provide good returns in a growing global economy. Global economic growth should average around 3.5%, which will be positive for the businesses that transact in the United States and across the globe,” Mr. Blum explains.

Equities tend to behave very differently than bonds, so they provide important diversification benefits. They can also protect against inflation, notes Mr. Blum. “This is important to keep in mind, as there’s a lot of liquidity in the system today. At some point, inflation may start to pick up, and equities usually benefit in times of rising inflation.”

Stocks tend to behave very differently than bonds. In today’s interest rate environment, equities are a good first step if you own too much cash or too many bonds.
Isn’t it too late to invest in equities?

Although markets have rallied over 100% from recent lows, we don’t believe that those looking to invest now have missed the boat. As Mr. Blum explains, “If you look at equities today versus their last peak in 2007, they are still cheaper despite the run-up, but corporate earnings in the United States are 20% higher now than they were back then.”

It’s certainly not too late to increase your allocation to equities, if appropriate, according to Mr. Blum. Investors may want to consider phasing into markets gradually, a strategy that seeks to lessen the risk of allocating a large amount to an investment at the wrong time.

Mr. Blum adds, “It’s important to keep in mind that the world is likely to be a better place than it has been for the last couple of years, and in that environment, when you are buying equities, you are buying the earnings power of companies that we think will increase over time.”

Take a fresh look at your investments

As the markets change, reviewing your asset allocation with your financial advisor can help you stay on track. Work with your advisor to ensure you have the right diversified mix of assets.