Taking the Long View

Why Short-Term Metrics Fall Short for Goals-Based Investing

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It's easy to get swayed by annual forecasts or quarter earnings reports. But short-term perspectives can distract investors from longer-term challenges looming on the horizon.

The risk to both retail and professional investors is tinkering and tweaking portfolios in response to short-term "noise" and recent performance. The primary objective for investors with long-term goals should be to achieve their goals on time. Long-term goals require a longer-term view of the markets and risks.

Dual Dilemma: The Long-Term Challenges

Long-term investors face a daunting dual dilemma:

- If bonds fail to repeat their stellar returns of the last 35+ years and if U.S. and global public companies can't deliver the perfection reflected in their market prices,
- then portfolios may not provide the returns investors will need.

It is no surprise that annual return forecasts for capital markets over the next 5 to 10 years by major institutions are muted. This has meaningful implications for the typical 60/40 portfolio (60% stocks/ 40% bonds), shown below.

Forecasted Returns over Next 5 to 10 Years

Source	Organization	Equities	Bonds	Implications for 60/40 Portfolio
Vanguard[1]	Vanguard	4.0%	3.5%	**3.80%**
BlackRock[2]	BlackRock	6.8%	3.3%	**5.40%**
Rob Arnott[3]	Research Affiliates	0.7%	0.5%	**0.62%**
JP Morgan[4]	JP Morgan	5.3%	3.5%	**4.55%**
Morningstar Investment Management[5]	Morningstar	1.8%	3.3%	**2.40%**
SSGA- Long-Term Asset Class Forecasts[6]	State Street Global Advisors	6.4%	3.1%	**5.08%**
BNY - Ten Year Capital Market Assumptions[7]	BNY Mellon Investment Management	6.2%	2.7%	**4.80%**

Source: Swan Global Investments. Forecast information pulled from numerous sources as of January 2019*

Historically, financial planners assumed an average annual return for long-term investor portfolios in the range of 6% to 7% per year. Chasing yield or returns can lead to nasty outcomes as investors move away from safer fixed-income positions to riskier ones. We've written many times about the weaknesses of Modern Portfolio Theory and the state of the traditional 60/40 portfolio because we believe these are fundamental investing and market challenges that investors need help navigating over the long term.

To achieve long-term objectives in the face of these muted return forecasts, we believe investors are better served by applying more strategic, long-term portfolio solutions than consistently making frequent portfolio adjustments based on short-term outlooks.

Shortcomings of Short-Term Views

Potential for Taking on More Risk

Short-term outlooks may encourage investors to take on more risk as they seek out yield or returns in hot sectors or trendy momentum picks. As a result, they take on more risk than they might want to or understand—a fact demonstrated by lower and lower credit qualities seeping into client portfolios.

In a low-yield world, return chasing may lead to overweighting to equities. Over the last 50 years, the S&P 500 Index averaged 9% return per year. However, after a lengthy bull market (the second longest in history based on daily total returns), the S&P 500 Index now has a trailing 10-year average annual return of over 13%. Investors may now begin to expect or even demand similar equity returns going forward.

Highlighting a good quarter or year doesn't necessarily illuminate how well a fund manager performed over meaningful periods of time or how they will perform going forward. Looking at monthly, quarterly, or even yearly trailing returns is like sprinting a marathon. It will get you to the next milestone quickly but is that a sustainable way for running a long distance?

Following the Market on the Way Up and the Way Down

By extension, investors checking their account balances every day, month, or quarter may result in potentially detrimental short-term changes as they compare short-term performance to the S&P 500 or other indices. Adjusting portfolios to mimic strategies or investments with strong recent returns or to match indices may result in the portfolio behaving too much like those investments when large sell-offs occur.

It may also encourage investors to lose sight of the long road ahead and the endurance necessary to stick to their financial plans.

Inconsistent Expectations

Furthermore, a shorter-term performance focus not only fails to determine where investors are headed or what steps they need to take to get there, but rarely provides the recipe for success. Market-timing strategies that rely upon being right about a wide range of inputs and getting the timing right regarding entry and exit of a host of investments over and over again have a low probability of sustainable success. Few can successfully time the market over 1-5 years, and even fewer can do this over 10 years or more.

Ultimately, it's not about beating the market and looking like this year's hero. Investors face significant challenges that require solutions with horizons beyond the next quarterly or annual meeting. This is a big opportunity for financial advisors to help their clients successfully navigate these challenges.

Refocus on Long-Term Consistency

Long-term investors will inevitably face one or multiple bull and bear markets, so investment strategies that can deliver stable, consistent returns over full market cycles are better suited for investors with long-term horizons.

Short-term metrics do not measure consistency, and therefore do not necessarily offer meaningful insights into long-term investment planning. Making a decision for a financial plan that spans over 10, 20 or more years based on a metric that only looks back a quarter or year is at best useless and at worst actually harmful to a long-term, goals-based process.

The sign of an effective goals-based strategy is its ability to provide consistent returns over long-term rolling periods.

It’s not about the last quarter, or last year or next year. It’s about the next ten years—and beyond.

Important Notes and Disclosures:

*Sources for returns:

1. January 2019. https://pressroom.vanguard.com/nonindexed/Research-Vanguard-Economic-and-Market-Outlook-2019-120618.pdf Based on U.S. equities and U.S. fixed income. *Mean of the range of capital markets return assumptions provided by Vanguard.
2. December 2018. https://www.blackrock.com/institutions/en-us/insights/charts/capital-market-assumptions Based on U.S. large cap equities and Barclays U.S. Aggregate Bond Index.
3. December 2018. https://interactive.researchaffiliates.com/asset-allocation#!/?currency=USD&model=ER&scale=LINEAR&terms=REAL Based on U.S. large cap equities and Bloomberg Barclays U.S. Aggregate Bond Index. RA states their returns forecast in real terms.
4. October 2018. https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/portfolio-insights/long-term-capital-market-assumptions Based on U.S. large cap equities and U.S. 30-year bond.
5. September 2018. https://www.morningstar.com/articles/907378/experts-forecast-longterm-stock-and-bond-returns-2.html Based on U.S. large cap equities and U.S. bonds.
6. September 2018. https://www.ssga.com/na/us/financial-advisors/en/our-insights/publications/ssga-long-term-asset-class-forecasts-september-2018.html Based on U.S. large cap equities and U.S. Bond Aggregate
7. January 2018. https://www.bnymellonwealth.com/assets/pdfs-strategy/thought_capital-market-return-assumptions.pdf Based on U.S. large cap equities and U.S. Bond Aggregate.

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