Why time in the markets beats trying to time them

By Tony Kaye, Vanguard Investments

Thirty years ago, when the Australian economy was last in a recession, cash delivered a spectacular annual return of 18.5%, making it the best-performing single asset class.

But 1990 was a bad year for our share market, with Australian shares producing a dismal annual return of 4.1%.

It's an interesting comparison with the year to 30 June 2020, with the Australian share market having delivered a minus 7.2% return following the sharp falls over February and March induced by the outbreak of COVID-19.

Cash, reflecting record low interest rates, returned just 0.8%. And, to join the dots back to 1990, Australia is now back in another recession that we unfortunately had to have.

For many self-managed superannuation fund (SMSF) trustees, the returns from Australian shares, and cash in particular, are extremely relevant.

Australian Tax Office data on SMSF holdings shows Australian shares accounted for almost one-third ($170 billion) of total member assets at the end of March. Cash was the second-biggest asset for SMSFs, accounting for roughly 27% ($150 billion).

The long-term returns picture

Returns from different asset classes always vary from year to year, which is where an analysis over the last 30 years gives a much better perspective of long-term performance.

The recently released Vanguard 2020 Index Chart tracks the performance of six key asset classes over the period from 1 July 1990 to 30 June 2020 (Australian shares, United States shares, international shares, Australian listed property, and Australian bonds and cash).

What it shows is that a $10,000 investment into Australian shares 30 years ago would have been worth $130,457 at 30 June 2020 — equating to an 8.9% per annum return — based on the reinvestment of all dividend distributions.

The highest long-term asset class return has been from the US share market, where a $10,000 investment in 1990 would have achieved a 10.3% average annual return and grown to $186,799.

Australian listed property (real-estate investment trusts) has averaged 7.8% per annum, turning $10,000 into $95,395, with Australian bonds tracking slightly lower at 7.7% per annum ($93,545).

International shares, as a broader composite of different share markets, have trailed both Australian and US share returns. They've delivered a total return of 7.3% per annum ($82,969).

Cash, where SMSF trustees are heavily invested, achieved the lowest long-term investment return. Had $10,000 been left in a cash account, it would have grown to just over $44,000 based on its average annual return of 5.1%.

The index chart demonstrates the importance of good asset diversification in the context of the heavy concentration of SMSF assets into Australian shares and cash.

And that's something the ATO is focused on too as part of its new guidelines around how SMSF trustees should be documenting their investment strategies.

Trustees must now articulate in writing how they plan to invest, and why investing in specific assets will achieve their retirement goals. Those with limited diversification need to document that they have considered the risks associated with a lack of diversification.

The importance of staying the course

Investing always has inherent risk factors, and there's no guarantee the asset class returns since 1990 will be replicated over the next 30 years.

Yet there are clear lessons for all investors from the past 30 years, keeping in mind this period incorporated disruptive market events, such as the Asian financial crisis in the late 1990s, the dot-com crash in 2000, the global financial crisis from 2008, and the impact of COVID-19.

While investment markets are prone to short-term volatility, they do have a strong track record of delivering long-term capital growth.

A joint survey of more than 3,000 SMSF trustees by Vanguard and Investment Trends conducted between February and May 2020 found there was a strong switch to defensive assets by many trustees in response to the latest market uncertainty.

This led to increased allocations to cash and property, although the SMSFs surveyed indicated they are keen to rotate back into blue-chip shares and exchange traded funds (ETFs).

However, trying to cherry pick exactly when to buy and sell assets based on the constant ups and downs of markets is extremely difficult, if not impossible.

Those who cashed out of equity markets in February may have totally missed the strong rebound since then.

That comes back to staying the course with your investment strategy and tuning out from the day-to-day noise that drives markets.

And it's important to be invested across a range of asset classes to smooth out lumpy investment returns and to reduce portfolio volatility.

Lastly, the power of compounding investment returns should never be underestimated. Even a low initial balance will grow substantially over time when additional capital is added.

Successful investing revolves around having a well-planned and diversified strategy, keeping investment costs low, and sticking to your plan, even during volatile investment times.

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