The Red House

The Lost Decade

"Equities fail to perform in the first decade of the 21st century" "The FTSE fails to deliver"

Bad news will always trump good in any sector – be it sport, business, investment or the private lives of celebrities. The reason is well-known to psychologists; A loss hurts more than a gain. A loss of £1,000 will usually cause more emotional pain than the joy a gain of £1,000 brings.

The doomsayers in the media have had a good time in 2010 documenting the poor performance of the equity asset class during the previous ten years. The data confirms the poor returns. The FTSE All Share index showed a real (after inflation) annualised return of -1.01% over the decade. Similar returns have created the same despondency in the US with their main indices posting negative returns over the same period. Should we at TRH be concerned enough to review the inclusion of equities in our portfolios?

A firm no is our response. Let us explain why.

1. The FTSE is not the story!

The lost decade story is based on the performance of the main equity indices – the FTSE All Share, the FTSE 100 and the S&P 500 etc. over the period.

We would not expose our clients to the risk of a single market. The performance of the FTSE All Share or the more commonly quoted FTSE 100 is of little use in measuring the returns our portfolios achieve for our clients.

At TRH we build diversified portfolios designed to capture the expected returns from the main equity asset classes – domestic, international and emerging markets, and small and value company stocks. We then dampen the risk of equity investment by progressively adding exposure to global short dated bonds. An individual client's exposure to equities in their portfolio is entirely dependent on the risk they both need and are willing to take.

2. Don't forget inflation!

Many performance comparisons show past returns in nominal terms. One of the main reasons to invest in equities is to protect one's wealth in real, which means after inflation, terms. We will never claim to be able to make a client rich – our clients tend to be pretty good at that themselves. Our primary aim is to try and make sure they stay rich by preserving the value of their investments in real terms.

3. TRH's past performance

TRH portfolios have a two year history to 31 December 2009 however it is possible to simulate the returns over a longer period by the use of appropriate asset class indices. .We have crunched the numbers to produce the following chart. The chart shows the performance of the FTSE All Share index and the simulated past performance of TRH portfolios 6, 4 and 3 for the period 01/01/2001 to 31/12/2009.

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	1 year	3 years	5 years	10 years
FTSE All Share	27.07%	-3.71%	3.57%	-1.01%
Growth of £1 million	£1,270,000	£890,000	£1,190,000	£900,000
TRH 6	23.87%	-5.00%	3.71%	1.69%
Growth of £1 million	£1,240,000	£860,000	£1,200,000	£1,180,000
TRH 4	15.39%	-0.87%	3.77%	3.06%
Growth of £1 million	£1,150,000	£970,000	£1,200,000	£1,350,000
TRH 3	11.16%	0.86%	3.48%	3.45%
Growth of £1 million	£1,110,000	£1,030,000	£1,190,000	£1,400,000

- Returns are annualised and adjusted for inflation
- TRH portfolio performance based on proxy indices as actual portfolios have a 2 year history only
- TRH portfolios are rebalanced annually with no CGT assumptions made
- Performance figures do not include fund and provider fees (see below)
- All income arising assumed reinvested
- Source: DFA Returns programme

The chart confirms the bad news for the FTSE All Share index with an annual return of -1.01% over the period. TRH portfolios do not include charges so it would be reasonable to allow for up to 0.8% pa for fund management and platform charges. However, after deducting this sum the simulated returns show that even the full equity TRH 6 portfolio produced a real return, after inflation and charges, of 0.89% pa (1.69%-0.80%). The lower risk TRH 4 and TRH 3 portfolios showed real (net of charges) annualised returns of 2.26% and 2.65% pa respectively over the decade.

So what does this tell us? In a nutshell diversification and discipline works.

It must of course be remembered that TRH returns in the chart are simulated however they do give a good indication that had these TRH portfolios been available, our clients would have protected their investment wealth in real terms over the period.

Gareth Marr and Matt Kiddle

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Regulatory notes

The simulated past performance is based on the actual past performance of financial indices which are the same as, or underlie, the investment concerned. The figures for the TRH portfolios refer to simulated past performance, past performance is not a reliable indicator of future performance. This document is intended for informational purposes only and no action should be taken, or refrained from being taken, as a consequence of it without consulting a suitably qualified adviser. Please contact The Red House (TRH) if further information is required. Any opinions or estimates contained in this document represent the judgement of TRH at this time, and are subject to change without notice.

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