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The Importance of Stabilisers

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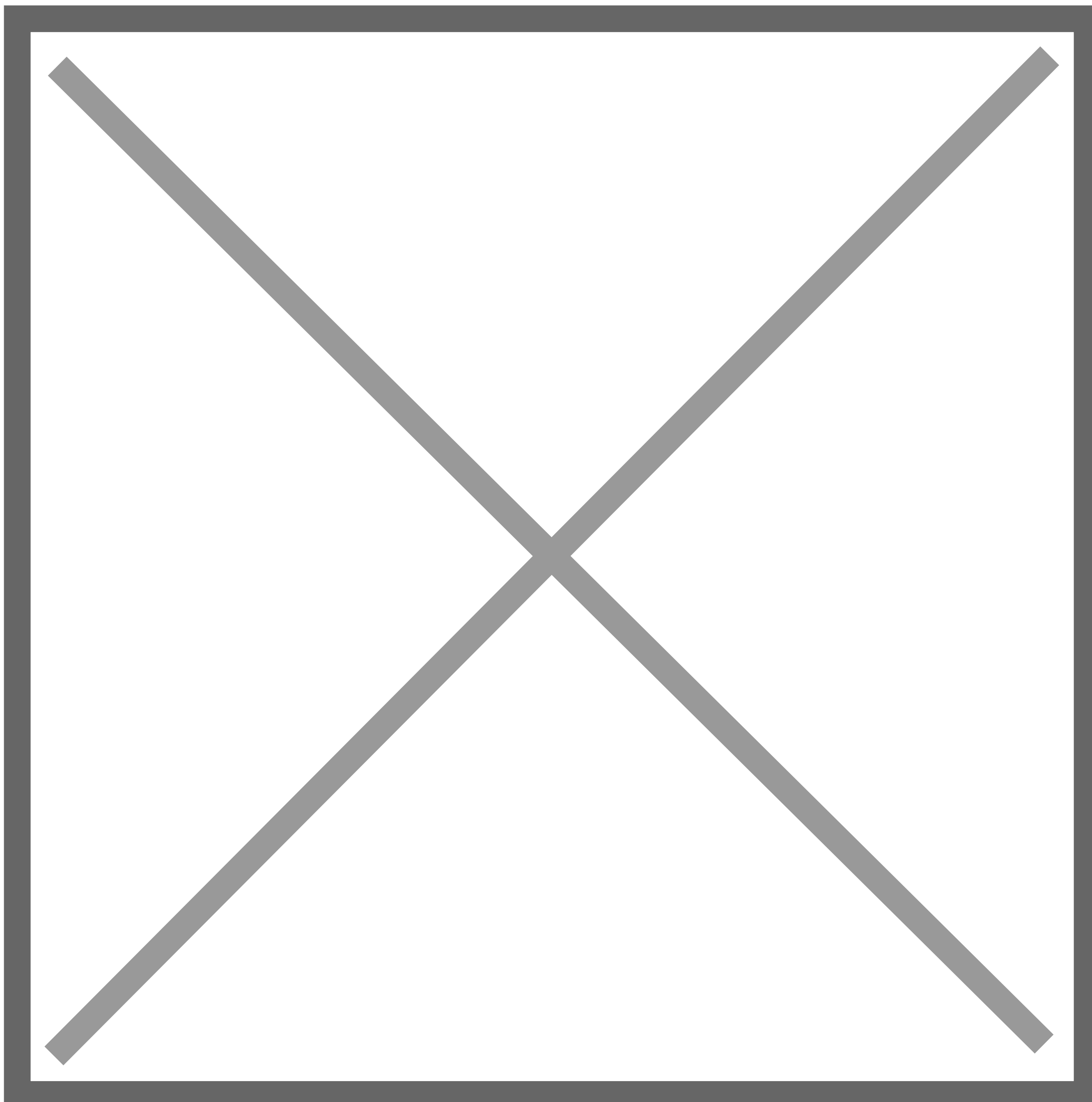
Although we have recently become more optimistic about certain equity markets over the last few weeks, the importance of stabilisers in a portfolio cannot be over emphasised.

The Figure below shows the returns of a broad UK equity index versus index-linked bonds.



The job of a stabiliser is to act as a hedge against uncertainty. When equity markets fall as they did in 2008 and 2015, index-linked government bonds act as a stabiliser and reduce drawdowns.

Don't assume because we aren't distracted by normal volatility that we don't care about risk. The risks that worry us are the risks that should worry you – those that take you by surprise and lead to a permanent loss of capital. That's why each portfolio has a stabiliser element to it, like index-linked bonds, gold or cash.

These stabilisers help reduce the downside when something like a tech crash or liquidity crisis explodes on the markets. They also help insure portfolios from us not getting all our calls right.

When we build portfolios, we understand that each client has a "risk budget". The more adventurous the investor the greater the risk budget. We look at how we can use their risk budget most efficiently to generate strong returns – what are the assets we really want to own at this point in the market cycle? We then use the rest of the portfolio to mitigate the risks necessarily taken.

Of course, another way to mitigate drawdowns is to time the market. However, no one can consistently time the markets perfectly. This would require insights about the future that the laws of physics do not currently permit.

If one was to buy the broad UK equity index 10 years ago, you would have achieved 10% annualised returns. If you tried to time the market and simply missed the best 30 days, your annualised returns over this period dropped to a paltry 0.4%. Adjusting for inflation, this means you lost almost 3% every year by trying to time the market.

What matters isn't timing the market but **time in the market**. The power of compound interest helps you reach your financial goals and the job of the stabilisers in our strategies is to make that journey a little smoother.

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