



# Managing risk in a low-growth world

## Colin Moore, Global Chief Investment Officer



Your success. Our priority.

You really need to discriminate much more in how you invest going forward.

I think the equity market is pretty richly valued. I agree that U.S. equities are probably more attractive than others around the world because we have relative stability. You may not think that given what's happening politically at the moment, but the U.S. looks relatively stable compared to the potential turmoil in Europe from Brexit, disruptions in Japan, etc. But our expected return from U.S. equities is modest at 5% or 6% and you're picking up 12% to 18% volatility when you invest in that. And that's not a particularly attractive trade off to me.

I think people get too optimistic about the broad level of economic growth and then, secondly, they don't adjust enough when that growth is lower to investing in a different way. If you think that economic growth is going to be very high, you would invest in broad based market indices to capture all of the elements of the rising economy. I don't believe that is happening. I think economic growth will continue to be in that 1½% to 2% range, and in which case you have to look for the pockets of growth that will emerge from that as opposed to this broad based growth concept. Then if we think about the volatility that you get for this low growth environment. When you're that close to the cliff edge an ill wind makes you fearful of falling over the side, that's akin to the spike in risk premia you get when an economic or political shock occurs in a low growth environment. Therefore we have to think about the consistency of the returns that we get. Therefore, how we allocate risk within a portfolio should not be just based on the highest expected return, which is probably equities, but also what is the best combination of risk and return that we can get.

We try to balance out this combination of risk and return tradeoffs in treasury bonds, in U.K. gilts, in European equities and Japanese equities, in U.S. equities, in multiple asset classes, to determine what would be the best combination that then will deliver a final result that the client can live with. Most of our work shows that clients can handle 8% to 10% volatility. If you get much more than that, we get this characteristic of even though the returns are attractive, people don't earn those returns. Because of course they sell low and buy high, they behaviorally react the wrong way. So when we're trying to create portfolios that are much more stable, that have that correct balance between risk and reward, so that they'll stay with their investment for the long term and therefore earn the return that we're expecting to get from them.

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