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4 Sound Long-Term Investment Strategies

Become a confident, empowered investor

If you're investing in today's markets, this guide shares four sound long-term investment principles designed to empower and instill confidence, particularly for cautious investors. Use these strategies to support your overall long-term financial goals while building a resilient investment portfolio that can withstand any type of market:

1. Diversify – Globally, across sectors and industries and in a mix of asset classes

2. Know your risk tolerance

3. Focus on long term value

4. Consider working with a professional team

DIVERSIFY

Robust portfolios depend on diversification – and this goes beyond merely holding different stocks. A diversified portfolio that is also resilient will allocate:

- **Globally**

One common behavioral bias is home bias, a tendency to invest merely in U.S. stocks. A portfolio containing developed international countries as well as emerging markets may provide more growth potential while minimizing the effects of economic problems in any one region or country.

We have been in a period where large U.S. companies are the darlings of the investment world. Many investors seem to expect this to continue forever. However, we've seen this show before, and history suggests it won't last. The early 1970s had the Nifty Fifty, and the late 1990s saw the dot-com bubble. Both periods experienced a notable market shift: in the 1980s, Japanese dominance emerged, and in the early 2000s, there was a transition to aspirations of BRIC (Brazil, Russia, India, and China) strength. These expectations were anticipated to persist well into the first half of the 21st century. Because market cycles ebb and flow, be sure to consider the compelling valuations of companies overseas to globally diversify your portfolio.

- **Across sectors and industries**

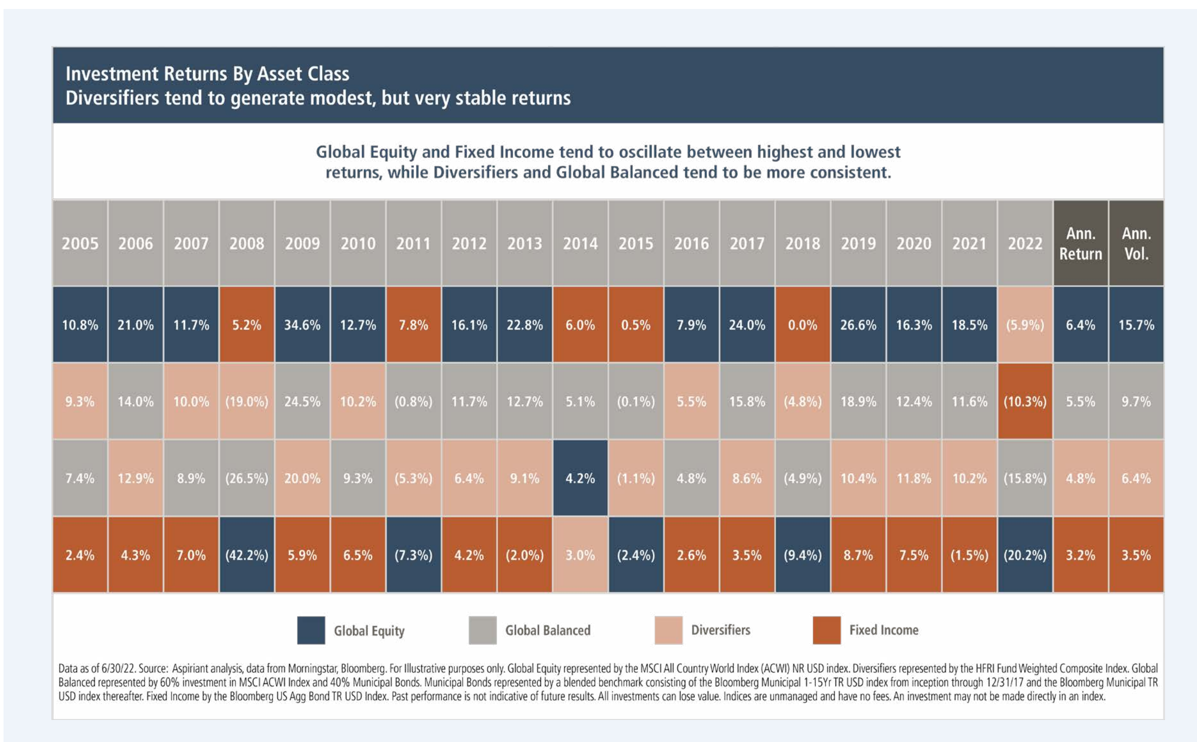
  In recent decades, market bubbles and collapses have been associated with specific sectors, such as the late 1990s dot-com bubble and the Global Financial Crisis sparked by risky real estate lending in the mid-2000s. More recently, the tech industry has been experiencing tough losses after a few years of strong gains and high valuations. A resilient portfolio should therefore contain a mix of sectors. Diversifying is particularly important if you have a high portion in equity compensation where you work. Being invested in other sectors and industries can help balance out that concentrated risk.

- **In a mix of asset classes**

  Portfolios are often described in terms of stocks and bonds. A higher-risk portfolio is typically comprised of 80% stocks and 20% bonds, while a lower-risk portfolio would hold the opposite (20%/80%). 60% stocks/40% bonds is generally considered a balanced portfolio.

  But there are other asset classes, such as real assets and diversifiers, that are less correlated to major markets. Real assets include infrastructure, real estate and commodities. Diversifiers are strategies such as merger arbitrage (exploiting pricing discrepancies related to mergers and acquisitions), global macro (investing based on large-scale events and trends), and long/short equity or credit (making investments in both long and short positions), just to name a few.

  As the chart below shows, diversifiers have a historical tendency to fall in the middle of the risk spectrum, providing a stabilizing effect in portfolios. During a period of rising interest rates and a sell-off in equities, diversifiers can be the best part of your portfolio.



Investment Returns By Asset Class
Diversifiers tend to generate modest, but very stable returns

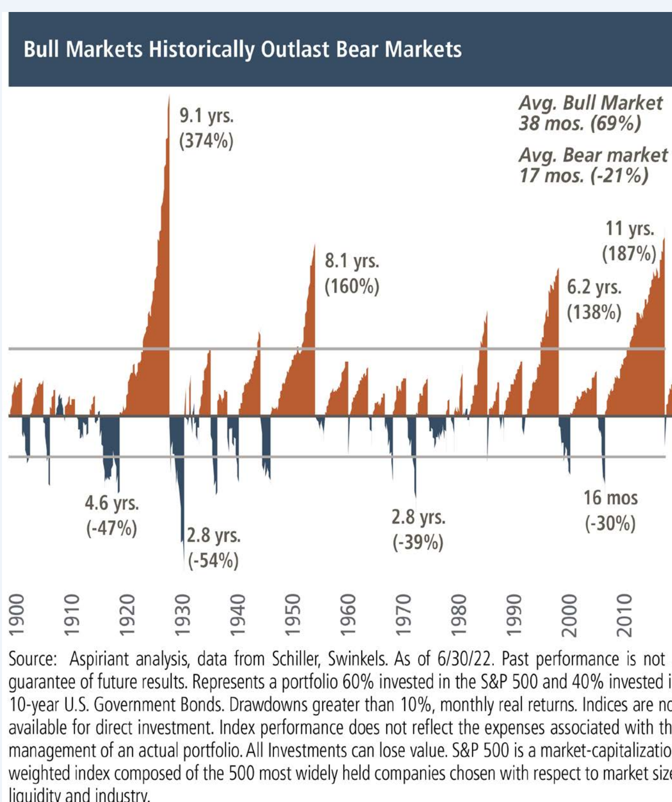
Global Equity and Fixed Income tend to oscillate between highest and lowest returns, while Diversifiers and Global Balanced tend to be more consistent.

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Ann. Return	Ann. Vol.
10.8%	21.0%	11.7%	5.2%	34.6%	12.7%	7.8%	16.1%	22.8%	6.0%	0.5%	7.9%	24.0%	0.0%	26.6%	16.3%	18.5%	(5.9%)	6.4%	15.7%
9.3%	14.0%	10.0%	(19.0%)	24.5%	10.2%	(0.8%)	11.7%	12.7%	5.1%	(0.1%)	5.5%	15.8%	(4.8%)	18.9%	12.4%	11.6%	(10.3%)	5.5%	9.7%
7.4%	12.9%	8.9%	(26.5%)	20.0%	9.3%	(5.3%)	6.4%	9.1%	4.2%	(1.1%)	4.8%	8.6%	(4.9%)	10.4%	11.8%	10.2%	(15.8%)	4.8%	6.4%
2.4%	4.3%	7.0%	(42.2%)	5.9%	6.5%	(7.3%)	4.2%	(2.0%)	3.0%	(2.4%)	2.6%	3.5%	(9.4%)	8.7%	7.5%	(1.5%)	(20.2%)	3.2%	3.5%

Data as of 6/30/22. Source: Aspiriant analysis, data from Morningstar, Bloomberg. For Illustrative purposes only. Global Equity represented by the MSCI All Country World Index (ACWI) NR USD index. Diversifiers represented by the HFRI Fund Weighted Composite Index. Global Balanced represented by 60% investment in MSCI ACWI Index and 40% Municipal Bonds. Municipal Bonds represented by a blended benchmark consisting of the Bloomberg Municipal 1-15Yr TR USD index from inception through 12/31/17 and the Bloomberg Municipal TR USD index thereafter. Fixed Income by the Bloomberg US Agg Bond TR USD Index. Past performance is not indicative of future results. All investments can lose value. Indices are unmanaged and have no fees. An investment may not be made directly in an index.

KNOW YOUR RISK TOLERANCE

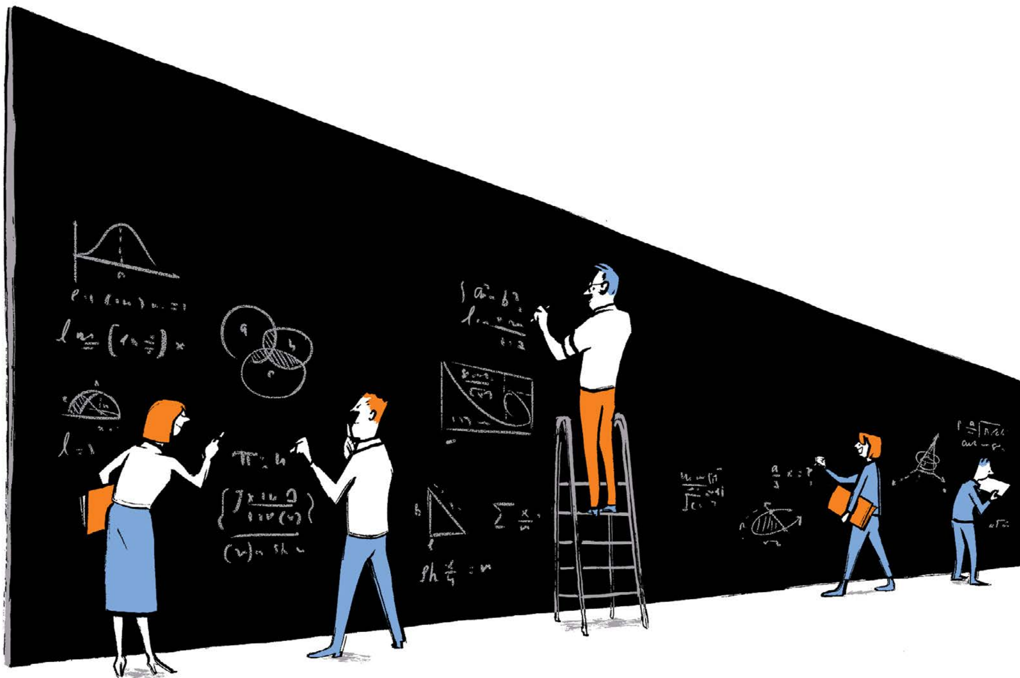
A robust investment strategy must account for your time horizon and your ability and willingness to take risk. A pool of capital you expect to use within a shorter period, say for a home or business start-up in the next two to five years, should be invested in a portfolio that is weighted toward fixed income, cash equivalents and other lower-risk assets. Assets not needed for many years can include a higher weighting to stocks but be sure you have the fortitude to withstand bear markets. While bear markets are usually much shorter than bull markets, as shown on the chart below, they can have an outsized impact on portfolios used as a source of distributions (where you are taking money out of your portfolio for your lifestyle costs.) If you have more time to stay invested in the market, and therefore more time to recover from any potential losses, you may want to hold a portfolio with a higher risk allocation and more return potential.



Source: Aspiriant analysis, data from Schiller, Swinkels. As of 6/30/22. Past performance is not a guarantee of future results. Represents a portfolio 60% invested in the S&P 500 and 40% invested in 10-year U.S. Government Bonds. Drawdowns greater than 10%, monthly real returns. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. All Investments can lose value. S&P 500 is a market-capitalization weighted index composed of the 500 most widely held companies chosen with respect to market size, liquidity and industry.

Exercise caution when reevaluating your risk tolerance during a strong bull market or a market drawdown. Many investors tend to overestimate their ability to handle risk when the market is thriving, but this perception can significantly shift during a bear market. This shift in thinking often leads to ill-timed decisions on adjusting the risk posture of one's portfolio. Two key behavioral biases, overconfidence bias and recency bias, play a crucial role in shaping an investor's decision-making process. Overconfidence bias involves investors overestimating their abilities and underestimating risks, leading to a potentially skewed risk tolerance assessment. On the other hand, recency bias is characterized by an undue emphasis on recent market trends, assuming that current conditions will persist indefinitely. While it may be appropriate to make adjustments under certain circumstances, it is imperative to ensure that such changes are part of a larger, well-thought-out plan rather than driven by emotional reactions influenced by these biases.

Ultimately, your investment strategy should align with your goals. Understand what you're invested in and why. By applying sound principles to wealth management, you can develop skills to manage your emotions and brace for any market condition.



Following the math, and not the emotions, is what makes an investor successful.

FOCUS ON LONG-TERM VALUE

The value of an investment should boil down to the future cash flow available from the asset to the investor. Valuation-based investing is a framework to compare the value of that future cash flow relative to the asset's current price. Understanding the long-term growth potential of an investment is critical when developing an estimate or expectation of the investment's future cash flow.

For too long, much of the stock market, particularly in the U.S., saw unsustainable price growth with ephemeral earnings potential. Then COVID-19 hit, providing some industries with extremely high growth rates. Investors, influenced by recency bias, subsequently believed those unsustainable growth rates would continue. History has shown many times that investors expect unusually high growth to persist for far too long. The opposite is also true. This phenomenon, known as recency bias, causes too high of expectations in good times and too low in bad times. In the long-term, growth tends to return to its historical averages of mid-single digits and has a significant impact on valuations. Following the math, and not the emotions, is what makes an investor successful.

In a nutshell, it's the sage advice of buy low, sell high. No investor can perfectly time the markets. But professional investors who are deeply researching the markets can apply active investment strategies in asset selection by understanding the relationships between inflation, interest rates and asset valuations. They can recognize a good deal and identify investments where gains should be harvested.

As famous investor Ben Graham said: "In the short run, the market is a voting machine, but in the long run it is a weighing machine." Don't let the market fool you when something is too popular compared to its future potential.

CONSIDER WORKING WITH A PROFESSIONAL TEAM

Through thoughtful conversations, a wealth management team with fiduciary investment advisors can help you identify your core values, create a long-term financial plan and tailor an investment portfolio to align with your risk tolerance. This ensures your financial goals are met in both favorable and challenging market conditions. Look for a wealth manager who listens to you, cares about your concerns and your values, prioritizes your best interests, explains concepts in a language you understand, and fully answers your questions.

Professional investment advisors should go beyond cursory research and perform deep analysis of the overall economy and different investment markets. You want them to consider the effects of fiscal policy (driven by legislators) and monetary policy (decided by banking regulators, such as the U.S. Federal Reserve), track the political winds, and gather a wide range of perspectives to help you make well-informed decisions.

You don't have to weather markets alone. A professional, holistic wealth manager can help you build your confidence, stay on track and achieve more.

Learn more about investing in today's market by starting a dialogue with Aspiriant.

ABOUT ASPIRIANT

Aspiriant is a leading independent wealth management firm focused on offering comprehensive wealth planning and investment management services to affluent entrepreneurs, executives and families. Our clients often come to Aspiriant in the midst of a life or business transition where our specialists collaborate to orchestrate every aspect of the client's complex financial lives. Learn more at aspiriant.com

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