Coping with Uncertainty

December 2018

"Oil falls on middle-east uncertainty."

When financial markets are volatile, you often hear that "uncertainty" is the cause. This suggests that uncertainty comes and goes, but because financial markets are forward looking, and because the future is unpredictable, investors must cope with uncertainty all the time.

That can be hard, especially in volatile periods when the value of your investments is fluctuating from day to day. How can investors learn to cope with pervasive uncertainty?

PRICING-IN UNCERTAINTY

It is important to remember that the market is a very effective information processing machine. This means that millions of market participants around the world are continually assessing information and its expected effect on future cash flows and that prices change as participants act on this. It is therefore reasonable for you to work on the assumption that today's market level has priced in current uncertainty.

BENEFITS OF HINDSIGHT

Investors can also take comfort from remembering that our strategy, Portfolio*sense*® a globally-diversified portfolio has recovered from many periods of uncertainty and crisis.

For example, in 2008 the stock market dropped in value by almost half. It was a period of uncertainty so acute that the viability of global money markets as we know them came into question. Headlines such as "Worst Crisis Since '30s, With No End Yet in Sight,"[1] "Markets in Disarray as Lending Locks Up,"[2] and "For Stocks, Worst Single-Day Drop in Two Decades"[3] were elevated from the business page to the front page.

Every political or economic crisis poses different challenges and affects the market in different ways, but the experience of past events can help investors maintain perspective.

[1]. https://www.wsj.com/articles/SB122169431617549947.
[2]. washingtonpost.com/wp-dyn/content/article/2008/09/17/AR2008091700707.html.
[3]. http://nytimes.com/2008/09/30/business/30markets.html.

The temptation to react to events can be strong but reacting is not always the best thing to do. In the heat of the moment in the financial crisis, some people decided to sell out of stocks. Those that stayed the course and stuck to their approach have long since recovered from the crisis and benefited from the subsequent rebound in markets.

There have been many periods of substantial volatility in the past. **Exhibit 1** below helps illustrate this point. The exhibit shows the simulated performance of a balanced investment strategy (using one of our investment partners funds – Dimensional Fund Advisers) following several crises, including the bankruptcy of Lehman Brothers in September of 2008, which took place in the middle of the financial crisis. Each event is labelled with the month and year that it occurred or peaked.

Exhibit 1. The Market's Response to Crisis
Simulated Performance of a Balanced Strategy: 60% Stocks, 40% Bonds (Cumulative Total Return)

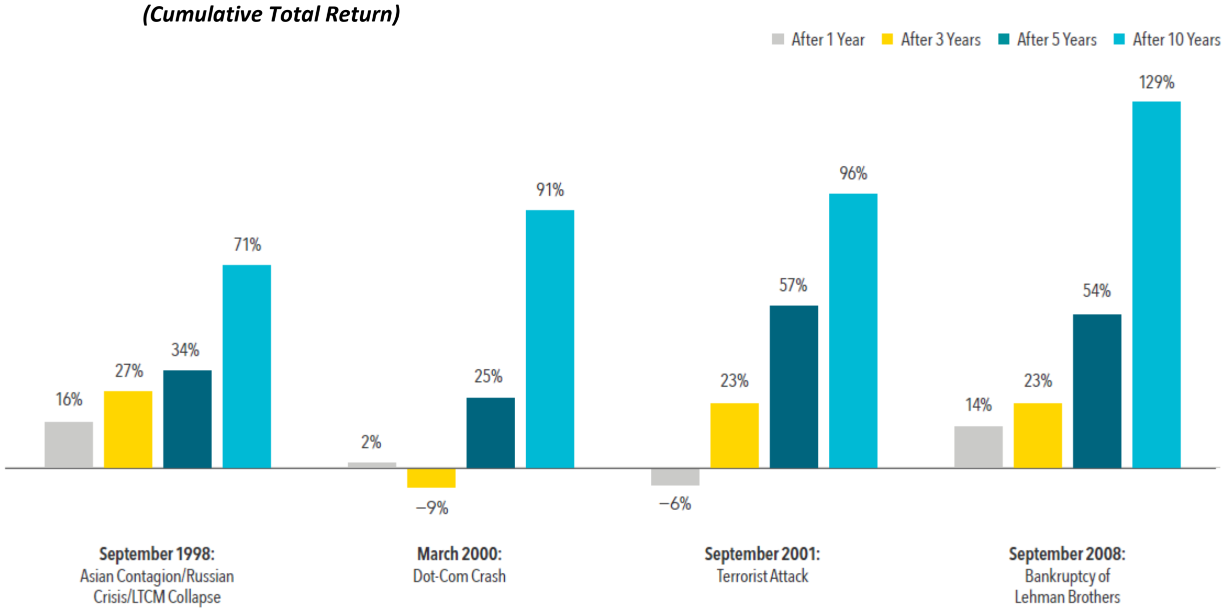

Exhibit 2 Performance as at 30 September 2018

Cumulative Returns (%)	1 Year	2 Years	3 Years	4 Years	5 Years
Balanced Strategy 60/40 (GBP)	5.68	16.16	38.63	39.64	48.71

Returns in GBP. Balanced strategy is composed of 60% Dimensional All Country World Core 2 Index and 40% FTSE World Government Bond Index 1-5 Year (hedged to GBP), rebalanced monthly. Returns for a given crisis begin the period following the crisis date shown and are not annualised (i.e. returns following the September 2008 crisis begin with the October monthly return). This is not a strategy managed by Dimensional Fund Advisors Ltd. or any of its affiliates. See the appendix for a description of the Dimensional index. FTSE fixed income indices copyright 2018 FTSE Fixed Income LLC. All rights reserved.

Although a globally diversified balanced investment strategy invested at the time of each event would have suffered losses immediately following most of these events, financial markets did recover, as can be seen by the three-, five- and ten-year cumulative returns shown in the exhibit.

In advance of such periods of discomfort, having a long-term perspective, appropriate diversification, and an asset allocation that aligns with their risk tolerance and goals can help investors remain disciplined enough to ride out the storm.

CONCLUSION

As we know, predicting future events correctly, or how the market will react to future events, is difficult. The good news is that being a successful investor does not rely on making accurate predictions. It is important to understand that market volatility is a part of investing and to enjoy the benefit of higher potential returns, investors must be willing to accept increased uncertainty. Accurately predicting the future is not a prerequisite to be a successful investor.

A key part of a good long-term investment experience is being able to stay with your investment philosophy, even during tough times. A well-thought-out, transparent investment approach can help people be better prepared to face uncertainty and may improve their ability to stick with their plan and ultimately capture the long-term returns of capital markets.

THE SMALL PRINT

Balanced Strategy 60/40: The model's performance does not reflect advisory fees or other expenses associated with the management of an actual portfolio. There are limitations inherent in model allocations. In particular, model performance may not reflect the impact that economic and market factors may have had on the adviser's decision making if the adviser were actually managing client money. The balanced strategies are not recommendations for an actual allocation.

Dimensional All Country World Core 2 Index: Compiled by Dimensional from Bloomberg securities data. The index targets all the securities in the eligible markets with an emphasis on companies with smaller capitalisation, lower relative price, and higher profitability. Profitability is measured as operating income before depreciation and amortisation minus interest expense scaled by book. Exclusions: REITs and investment companies. The index has been retroactively calculated by Dimensional Fund Advisors and did not exist prior to April 2008. The calculation methodology was amended in January 2014 to include profitability as a factor in selecting securities for inclusion in the index.

The Dimensional and Fama/French Indices reflected above are not “financial indices” for the purpose of the EU Markets in Financial Instruments Directive (MiFID). Rather, they represent academic concepts that may be relevant or informative about portfolio construction and are not available for direct investment or for use as a benchmark. Their performance does not reflect the expenses associated with the management of an actual portfolio. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Actual returns may be lower. See the appendix for descriptions of the Dimensional and Fama/French indexes.

The Dimensional Indices have been retrospectively calculated by an affiliate of Dimensional Fund Advisors Ltd. and did not exist prior to their index inceptions dates. Accordingly, results shown during the periods prior to each Index's index inception date do not represent actual returns of the Index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains.

The performance was achieved with the retroactive application of a model designed with the benefit of hindsight; it does not represent actual investment performance. Back-tested model performance is hypothetical (it does not reflect trading in actual accounts) and is provided for informational purposes only. The securities held in the model may differ significantly from those held in client accounts. Simulated performance may not reflect the impact that economic and market factors might have had on the adviser's decision making if the adviser were actually managing client money. This strategy was not available for investment in the time periods depicted. Actual management of this type of simulated strategy may result in lower returns than the back-tested results achieved with the benefit of hindsight.

Past performance (including hypothetical past performance) does not guarantee future or actual results. Performance may increase or decrease as a result of currency fluctuations. The simulated performance shown is "gross performance," which includes the reinvestment of dividends but does not reflect the deduction of investment advisory fees and other expenses. Investment returns will be reduced by the advisory fees and other expenses it may incur in the management of its advisory account.