Edison Wealth Management

Are there reasons to be cheerful?

6th March 2023

In a 2016 *New York Times* article, economic historian Deidre McCloskey wrote, “For reasons I have never understood, people like to hear that the world is going to hell.” Surging prices, striking unions, crumbling public services, growing taxes, spiralling interest rates and a dark comedy of political chaos have left us doubting whether the outlook is anything other than bleak. And that’s before we consider the impact of a potential recession. Is the world really going to hell?

There is great temptation in taking a pessimistic view of the future. The evolutionary rationale is certainly clear. Ancestors who reacted quickly to potential dangers, such as a rustling in the bushes, were more likely to survive thanks to their caution. This instinctual predisposition to negativity is still present in many of us today, as we tend to pay more attention to negative news rather than the positive.

The media also plays a role in amplifying this bias. Bad news is often more dramatic, grabs our attention and is shared more frequently on social media. However, the constant bombardment of negative news can lead to an overly pessimistic view of the world. In turn, it can adversely impact our decision-making, especially when it comes to investing.

In that context, you might think sitting out last year would have been worthwhile. Considering the long list of problems facing the world today, you might think doing the same in 2023 is prudent too. But thinking in this way can be harmful for wealth preservation and creation. One year is just a small moment in the lifetime of a portfolio and, on average, there are more ‘up’ years than down.

It’s also human nature to think that the present is especially uncertain, whereas the past was somehow more predictable, which is a fallacy. When it comes to investing, uncertainty is a good thing. If you wait until all future outcomes are certain, any potential returns will have already been and gone. As an investor, the willingness to take on risk is rewarded, so an uncertain environment is one that brings opportunity.

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The key is therefore to find balance; to distinguish between the signal and the noise. Instead of becoming overly optimistic or pessimistic, it pays to take a long-term view and focus on the fundamental drivers of performance. Effective diversification can also help to mitigate the individual risks that we can control.

Financial markets will always carry some level of risk, including a base level of risk that cannot be diversified away. But they also have a remarkable tendency to recover and grow over time. By focusing too much on the potential downsides, it's easy to miss out on the potential upsides of a recovery.

It is a useful moment to consider our balance of perspectives given the state of the UK and global economies today. Warnings of a recession grow louder by the week, so why aren't markets in freefall? One explanation is that the markets are forward-looking and, believe it or not, there are glimpses of good news.

Inflation is still uncomfortably high but appears to have clearly peaked in the US and is gradually slowing in Europe. Rate hikes are still with us but are expected to soften in 2023 as central banks require less drastic action to bring prices under control.

Most assets have performed badly over the last year, meaning they now trade at a sizeable discount. Low-risk assets such as gilts offer higher fixed returns compared to the last 10 years. Other markets are considered cheap by historical standards.

China's zero-Covid policy aimed to eliminate all new Covid cases within its borders, but we are now seeing it start to unwind. The strict lockdown measures and travel restrictions implemented to achieve this goal have resulted in a decrease in consumer spending, a decline in industrial production, and supply chain disruptions. Investors will be looking for signs of a rebound in economic activity as the country reopens.

Another consequence of the corrections last year is that many of our long-term return expectations have improved. Across equities and bonds, there are now even more compelling reasons for investors with long horizons to own certain asset classes.

We have recently completed our latest strategy review, to blend our outlook and analysis into a cohesive investment strategy. To do this, we use long-term estimates for risk and return for a range of asset classes and assess the overall effect of varying combinations.

Our data uses projections for key variables such as interest rates, inflation, and GDP growth. Using econometric models, these are adjusted for current and future events such as monetary policy decisions, geopolitical risks, and technological advancements – events that will have a real and lasting impact.

By adopting this longer-term perspective, we filter out the noise. This approach shows us where there are good and rational reasons to remain invested. Removing a bias for pessimism, we seek to avoid missing out on some of the best investment opportunities in the years to come, but without relying on simple naïve optimism.

If you have any questions on the above or to find out more about our investment service, please call 020 7287 2225 or email hello@edisonwm.com.

You can read more about us by visiting our website www.edisonwm.com.

Important Information

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This document does not constitute advice.

The value of investments and the income arising from them can go down as well as up and is not guaranteed, which means that you may not get back what you invested. Past performance is not necessarily a guide to the future.

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