

Diversification



Diversifying your investments across asset classes can be a valuable strategy for reducing performance volatility in your portfolio.

Possible client questions



“I read some recommendations for an asset that will be the best performer of the year. Should I move all my investments into this asset?”



“I know a lot about local equities. I feel more comfortable investing in something I know and am familiar with. What are the benefits of investing elsewhere?”



“Although I can see my money growing, I don’t feel comfortable with how often I see negative returns in my investments. How can I make the journey smoother?”



Key learnings



The past doesn't guarantee the future

Asset managers, quants and economists can create and test historical investment strategies and models to try and identify promising market opportunities. However, in reality nobody can always accurately predict market movements, so it is extremely difficult to know in advance which asset class will outperform others.



High Concentration = Higher Risk

If investments are concentrated in just one asset class, the performance can be more variable and the risks higher. Diversification reduces this. It makes more sense to have a blend of investments across asset classes to manage risk.



Matching risk to return

Assets such as bonds, property and equities have a low performance correlation with each other, as well as having differing risk/return characteristics. They can be combined in a tailored manner in your portfolio to target the desired return at a risk level which you are comfortable with.



Holistic investing

While it is tempting to regard each asset in a portfolio separately, the strength of a well-constructed portfolio lies in its diversity. Taking a holistic view of your portfolio and wealth is important when analysing return and investing.



Single asset class versus diversified volatility

The chart below illustrates the performance of various asset classes between 2005 and 2018. As can be seen, there can be significant variability in individual asset class returns from year-to-year. To illustrate the benefits of a diversified portfolio, the red dotted line follows a much smoother path compared with, for example, the global equities asset class as depicted by the (black solid line).

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Annual performance
21.7	42.4	18.1	9.2	51.6	31.8	8.2	31.3	40.9	15.9	1.3	14.3	25.5	2.6	7.4
21.4	26.5	16.2	4.1	50.3	20.4	5.5	28.7	23.4	8.4	0.6	11.8	24.6	2.6	7.3
15.4	21.5	12.6	(5.1)	38.3	16.8	4.8	18.4	9.7	7.6	0.4	9.9	15.2	(1.0)	6.6
12.0	15.2	12.2	(5.2)	35.4	15.7	4.1	18.3	6.2	7.3	0.1	9.5	12.0	(1.7)	6.2
11.4	14.6	8.5	(10.2)	27.2	14.5	0.4	16.8	6.1	4.7	0.1	8.7	11.4	(3.2)	5.7
8.7	13.9	6.4	(19.1)	25.7	13.2	(1.1)	16.3	4.4	4.1	(0.2)	8.5	10.0	(4.3)	5.2
7.6	11.1	5.7	(22.6)	22.0	12.5	(1.8)	13.8	0.4	4.1	(0.7)	7.5	7.8	(4.6)	4.8
6.3	10.6	5.7	(24.5)	18.9	12.3	(2.5)	10.9	0.2	3.4	(1.0)	6.2	7.1	(4.7)	4.7
5.1	5.2	3.2	(35.6)	18.6	10.9	(5.8)	7.7	0.1	0.3	(1.8)	5.0	5.7	(6.2)	4.3
3.8	3.6	2.1	(41.3)	16.6	7.2	(6.9)	4.5	(5.8)	(2.0)	(3.1)	3.8	2.1	(8.9)	4.2
3.5	3.1	(5.8)	(47.7)	1.4	3.4	(13.3)	0.8	(9.0)	(5.7)	(14.9)	1.2	1.7	(11.2)	2.1
3.4	2.1	(7.0)	(65.8)	1.0	0.4	(18.8)	(1.1)	(9.5)	(17.0)	(24.7)	1.1	1.4	(14.0)	(3.5)

- Listed Private Equity
- Commodities
- Listed Real Estate
- EM Hard Currency Debt
- Global Equities
- Diversified Portfolio
- Hedge Funds
- EM Local Debt
- Government Bonds
- High Yield Bonds
- Investment Grade Bonds
- Cash

Source: HSBC Private Bank (UK), Datastream
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