Investing In an Uncertain World

Confusion in Washington, rising tensions in the Middle East, an uncertain global economy – when the world at times seems to be coming apart, how should you go about investing your money? Unfortunately, reading the morning papers and watching CNBC is not particularly helpful in making profitable long-term investment decisions. Can investors approach the current market environment in a way that combines fundamental lessons from the past with knowledge of new challenges the world faces? The goal, we believe, is to build portfolios that correctly balance return opportunities with careful risk management.

The world is still, as it has always been a changing place with no sure bets for the future. Current conditions in the global economy point toward lower investment returns for the foreseeable future. Most developed countries face staggering debt loads built up from years of fiscal mismanagement. Entitlement spending has grown, while the ratio of workers to retirees continues to decline and pressure tax revenues. In addition, emerging market countries like China and India control an expanding share of the world's manufacturing base. Central banks have intervened in historical proportions in an attempt to stabilize the economy, providing short-term relief that could also reignite inflation.

The result is likely a slow-growth environment for several years in which it will be difficult for stocks to produce the 6.8% annual real-return (9.8% before inflation)[i] achieved over much of the last century. Bonds could struggle to produce returns much in excess of their current income yield, or around 2% for the Barclays Aggregate U.S. Bond Index. We also expect that both stocks and bonds will be more volatile in the future due to government attempts to manage excess debt by creating inflation.

In short, the next few years will not be easy for investors. In the 1980s and 90s, the markets produced double-digit returns and did the heavy lifting to grow assets and create retirement income and security. Now, everyone will need to work harder and invest smarter and more cost effectively to meet financial goals.

Still, turning our backs on the markets is not an option, as inflation and the resulting lost purchasing power may be the biggest risk of all for investors. And even though the outlook for stocks is lower returns, those returns could be substantially higher than for bonds over the next several years. The challenge is to construct an investment portfolio that manages the volatility and risks in the "new normal" world while capturing the opportunities for growth when they are available – a portfolio you can live with. Our *Industry Insight* section includes reports produced by our investment team along with articles from other professionals in academia and the industry, organized by what we believe are fundamental steps in any successful investment process.

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[i] Ibbotson Associates, *SBBI: Market Results for Stocks, Bonds, Bills, and Inflation 1926-2012*