Friends Provident International

The importance of diversification

Not for distribution in Hong Kong or Singapore.

The question on most investors' minds at the beginning of every new year is 'which financial markets will top the performance charts over the next 12 months?' In the media, so-called 'investment experts' regularly make their predictions as to which asset classes will perform strongly or poorly.

The danger is that these forecasts may encourage investors to allocate a large amount of their investment portfolio to certain asset classes at the expense of others.

These experts might be able to suggest potential opportunities, but it is more or less impossible for anyone to predict which investments will deliver the best return each year.

We believe the key to successful investing is to create a diversified investment portfolio that reflects your attitude to risk.

You can achieve diversification in a number of ways, but the two most popular approaches are:

1 By asset class

Financial markets move up and down at different times. As the table on the next page shows, it is rare for a particular asset class to consistently perform well year after year. For example, during the financial crisis of 2008, gold was among the few assets that produced a positive return. However, in recent years equities have returned to favour, while gold has lost some of its appeal.

Equities generally move in line with the fortunes and prospects of companies. Whereas the factors influencing gold prices are diverse in nature, so the performance of this precious metal tends to be independent of other asset classes.

With the right asset allocation, there is the potential for you to make a healthy return, while also reducing the risk of losing money during periods of volatility in the financial markets.

2 By country

The table also demonstrates the wide divergence in performance between both developed and emerging market equities over the last 10 years. More recently, US equities have outperformed emerging market equities.

Investing in more than one country can help you to diversify and reduce risk, but you must be comfortable with the levels of risk involved. You need to be aware that some countries can add extra risk to your investment portfolio. For example, developed markets like the UK and US are generally not as volatile as emerging markets, such as Brazil, Russia and China.

Asset class returns over the last 10 years

The figures below show percentage growth returns and are ranked in order of performance.

Highest return

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Indian Equities **37.5**	Indian Equities **49.2**	Indian Equities **65.2**	Global Treasury Bonds **10.2**	Indian Equities **89.5**	Gold **28.75**	Gold **9.6**	Asia Pacific Equities **22.7**	US Equities **32.4**	Indian Equities **27.3**
Emerging Markets Equities **34.5**	European Equities **36.4**	Asia Pacific Equities **40.5**	Gold **2.2**	Emerging Markets Equities **79.0**	Indian Equities **22.2**	Global Treasury Bonds **6.3**	European Equities **22.5**	European Equities **28.7**	US Equities **13.7**
Japanese Equities **25.6**	Asia Pacific Equities **33.7**	Emerging Markets Equities **39.8**	Japanese Equities **-29.1**	Australian Equities **76.8**	Asia Pacific Equities **19.9**	Global High Yield Bonds **3.0**	Indian Equities **21.8**	Japanese Equities **27.3**	Asia Pacific Equities **5.1**
Asia Pacific Equities **23.2**	Australian Equities **33.5**	Australian Equities **29.3**	Global High Yield Bonds **-30.2**	Asia Pacific Equities **72.5**	Emerging Markets Equities **19.2**	US Equities **2.1**	Australian Equities **21.8**	UK Equities **23.1**	Global Treasury Bonds **-0.8**
Australian Equities **14.9**	UK Equities **33.1**	Gold **24.3**	US Equities **-37.0**	Global High Yield Bonds **54.3**	Australian Equities **15.8**	UK Equities **-4.2**	Global High Yield Bonds **18.6**	Global High Yield Bonds **7.4**	Global High Yield Bonds **-1.6**
Gold **14.0**	Emerging Markets Equities **32.6**	European Equities **17.5**	European Equities **-45.0**	UK Equities **46.1**	Japanese Equities **15.6**	Australian Equities **-10.5**	Emerging Markets Equities **18.6**	Australian Equities **3.6**	Gold **-1.7**
European Equities **11.3**	Gold **16.1**	Global Treasury Bonds **10.6**	UK Equities **-49.4**	European Equities **33.9**	US Equities **15.1**	Japanese Equities **-14.2**	UK Equities **17.5**	Asia Pacific Equities **3.3**	Emerging Markets Equities **-1.8**
UK Equities **9.1**	US Equities **15.8**	UK Equities **7.1**	Australian Equities **-51.1**	US Equities **26.5**	Global High Yield Bonds **13.0**	European Equities **-14.5**	US Equities **16.0**	Emerging Markets Equities **-2.3**	Australian Equities **-3.4**
US Equities **4.9**	Global High Yield Bonds **13.2**	US Equities **5.5**	Asia Pacific Equities **-52.2**	Gold **22.8**	UK Equities **11.0**	Asia Pacific Equities **-17.1**	Japanese Equities **8.4**	Indian Equities **-3.5**	Japanese Equities **-3.7**
Global High Yield Bonds **2.6**	Global Treasury Bonds **6.4**	Global High Yield Bonds **3.9**	Emerging Markets Equities **-53.2**	Japanese Equities **6.4**	Global Treasury Bonds **5.9**	Emerging Markets Equities **-18.2**	Gold **6.1**	Global Treasury Bonds **-4.3**	UK Equities **-4.7**
Global Treasury Bonds **-6.7**	Japanese Equities **6.3**	Japanese Equities **-4.1**	Indian Equities **-61.5**	Global Treasury Bonds **2.6**	European Equities **2.4**	Indian Equities **-36.5**	Global Treasury Bonds **1.8**	Gold **-28.7**	European Equities **-5.8**

Lowest return

Source: Morningstar Direct, US dollar total returns, data as at 31/12/14.
The information shown refers to the past. Past performance is not a reliable guide to future performance.

Indices used

Asia Pacific Equities
represented by MSCI AC Asia Pacific ex Japan Index

Australian Equities
represented by S&P/ASX 200 Index

Emerging Markets Equities
represented by MSCI Emerging Markets Index

European Equities
represented by MSCI Europe ex UK Index

Global High Yield Bonds
represented by BofA Merrill Lynch BB-B Global High Yield Index

Global Treasury Bonds
represented by Barclays Global Treasury Index

Gold
represented by Morningstar Gold Commodity Index

Indian Equities
represented by S&P BSE SENSEX Index

Japanese Equities
represented by MSCI Japan Index

UK Equities
represented by FTSE All-Share Index

US Equities
represented by S&P 500 Index

As you can see in the above table, no one asset class is consistently the best or worst performer year in year out. This illustrates the need to have exposure to a blend of asset classes to help drive long-term performance and reduce the risk of being overly exposed to a single asset class.

Effective diversification in practice

When you invest in a fund, your money is pooled together with the money of many individual investors. Funds provide the benefit of instant diversification because, depending on the fund's investment objective and risk profile, they can invest in different companies, asset classes or countries. This reduces the effect that any one investment can have on fund performance.

All of the investment decisions are made by a team of investment experts, known as fund managers, who will make sure that their fund is properly diversified.

Words of wisdom

Sir John Templeton (1912-2008) was one of the twentieth century's most successful investors and he believed that diversification was a core element of a long-term investment strategy.

> **If you are diversified among different forms of wealth, nations and industries, you'll be safe in the long-run.**
> May 1995

> **The only investors who shouldn't diversify are those who are right 100% of the time.**
> The Templeton Touch

Comments sourced March 2015 from www.whatwouldjohntempletonsay.com

Investing with us

We offer a wide range of investment solutions, in multiple currencies, managed by some of the world's leading fund managers. Whatever your financial goals, level of investment experience or appetite for risk, you should find an investment solution that is suitable for you within our range. We can give you access to a variety of asset classes, geographical locations and specialist sectors. However, there are a number of factors that you should consider when making an investment with us.

Risk-reward relationship

The riskier the asset, the greater the potential for higher returns, but with this comes a greater probability that you could lose some, or even all, of your investment.

Lower risk investments such as fixed interest and cash mean less risk to your capital, but also less potential for achieving a higher return and your investments may not keep pace with inflation.

So, you could end up falling short of achieving your financial goals. Before you invest, it's important to establish with a financial adviser your attitude to risk.

Multi-asset funds

If you don't want to build your own investment portfolio, you could consider investing in multi-asset funds.

These funds offer the benefits of diversification – the knowledge that your money is being invested across a number of assets which tend to behave differently.

While the assets may not all perform well at the same time, it's less likely that they would all perform poorly over the same period.

Investment adviser

If you don't wish to select your own investments, you can appoint a professional investment adviser with the knowledge and experience to manage your portfolio.

www.fpinternational.com

Visit our website to learn more about our range of flexible savings, investment and protection plans.

Speak to your financial adviser today to see how we could help you secure your investment goals.

About Friends Provident International

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Friends Provident International has over 35 years of international experience in offshore savings and investments.

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