Schroders

Global Investor Study 2016

Investment outcomes: not what you'd expect

Schroders

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Overview

In the end it tends to come down to income. That is one of the principal conclusions of the Schroders Global Investor Study 2016.

It could be for helping fund retirement or children's education. It could simply be to supplement a salary. Whatever the reason, most people are investing to generate an income, even if they are not looking to take it immediately.

Unfortunately, our study also highlights varying degrees of understanding among investors on the different elements involved in building a pot of money to generate the income they want. So, for example, while our study shows people have a good grasp of how long they will live in retirement, it also reveals some greatly inflated expectations of the income that might reasonably be generated in the current climate.

Take retirement, for example, which naturally remains a key focus for most people. While the study's respondents identify supplementing retirement income as the leading reason to invest and broadly recognise they could live for two or more decades after they retire, relatively few understand the financial commitment this represents. In determining how much money is needed in retirement, longevity and investment return are intertwined – yet investors seem to be clear on only one half of the equation.

This lack of understanding has important ramifications for long-term financial provision, with our study suggesting it has a real influence on both return expectations and the timeframes over which people are willing to leave their money in individual investments.

On the first point, the income and long-term return expectations of investors, including financial advisers, appear to be significantly inflated. Around the world, the average level of desired income for consumers, for example, is 9.1% (see chart below) and so, with many countries' interest rates at or near historic lows, plenty of people look set to be disappointed.

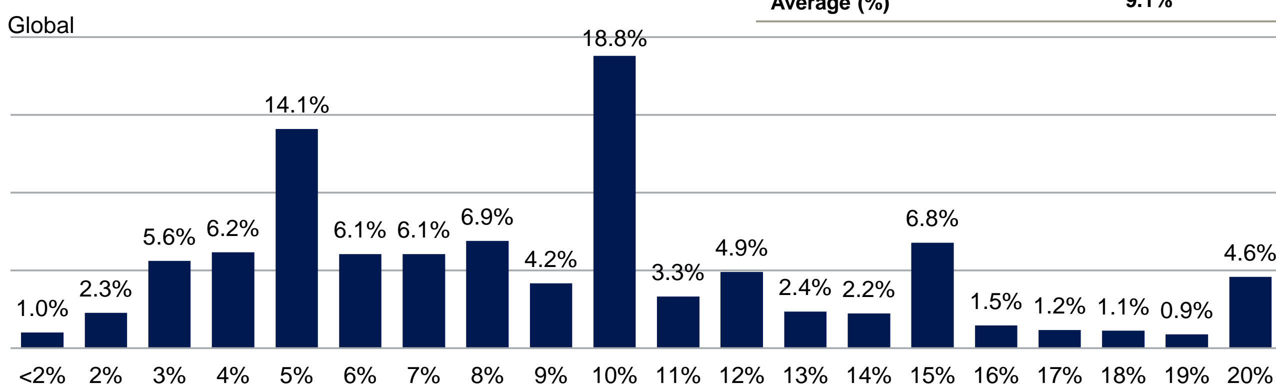
Chart 1: Investment income – consumers

Minimum desired level of income

Thinking about the income from your investments, (excluding cash savings and any properties), what is the minimum level of income you would like to receive?

- The overall average level of desired income, globally was 9.1%
- This compared to an average in Europe of 7.9%, Asia 9.7% and Americas 10.4%

Desired income	Global
Less than 10%	52%
10% – 14%	32%
15% – 20%	16%
Average (%)	**9.1%**



Such great expectations would be more realistic if investors were willing to take on a significant level of risk to achieve their goals; however, our study also shows capital preservation remains a real priority for most investors.

As for timeframes, private investors expect to hold their investments for around three years on average, while the corresponding number for advisers is around four. While this may be fine for cash and certain types of bonds, it will often prove too short a time period to counteract the volatility associated with equities.

Less than a fifth of respondents say they hold investments for at least five years – the minimum realistic holding period for equity investments. And there is particularly worrying news from the fast-moving world of the "millennial" generation, two-fifths of whom declare themselves comfortable with holding assets for less than a year.

The major risk here is anyone labouring under these two misapprehensions – that their investments will grow faster than is realistic and the pot they ultimately do build will pay a far higher income than is likely – is not going to be saving nearly enough to achieve their financial goals. Compounded over a 20 or 30-year time frame, the gap is potentially huge, making the mismatches between expectation and reality identified by the Schroders Global Investor Study 2016 a cause for real concern.

Why do people invest?

Children are a key investment driver, our study finds. Almost a quarter (23%) of respondents invest to provide an income for their offspring while a fifth do so to contribute to education fees. With the Centre for Economics and Business Research[1] now estimating the average cost of raising a child to be £231,843 – an increase of 65% since 2003 – such sentiments are entirely understandable.

For many people, however, generating an income to support them in retirement remains the biggest single reason to invest, with almost half (45%) of respondents investing to supplement their pension or annuity income. That said, similar numbers are just investing for growth (44%) and/or to supplement a salary or other income (43%). In contrast, our study finds relatively few people investing to provide their sole source of income (13%) or to help meet monthly mortgage or rental payments (12%).

In the UK, it will be interesting to see how the views of investors change as the impact of the pension freedoms becomes more widely felt. As individuals take advantage of the greater opportunities to manage their pensions as they see fit, they may start to look at investments in a whole new way.

Investment horizons

A timeframe of five years is usually suggested as the minimum for equity market investment on the basis this allows investors to experience the ups and downs of a normal market cycle; though, as ever with investment, nothing is guaranteed.

To offer an illustration, analysis[2] by Ritholtz Wealth Management of the S&P 500 between 1927 and 2014, shows the benchmark US index recording positive returns across 88% of all five-year periods. For the record, that figure rises to 94% for 10-year periods while there has yet to be a negative return over a 20-year timeframe.

Nevertheless, our study finds the average amount of time private investors are willing to leave money in an individual investment is 3.2 years. As the left-hand chart overleaf shows, less than one-fifth (18%) of respondents are willing to invest for more than five years while almost one-third (31%) stay invested for less than 12 months.

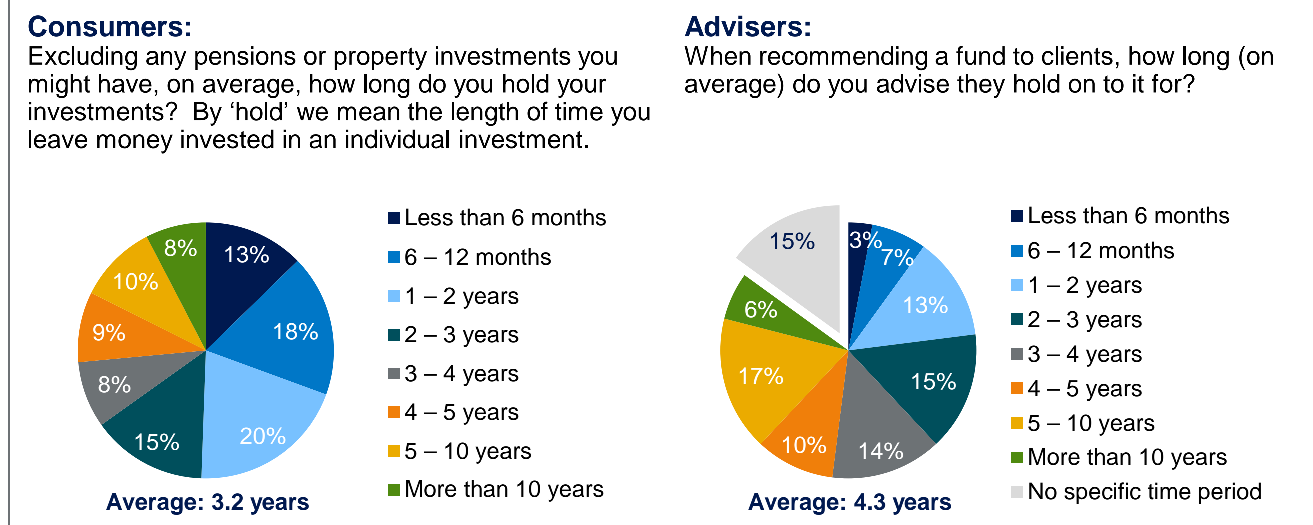
This echoes previous studies showing investors are becoming more short-term in their approach. As an example, the latest Investment Association Asset Management Survey[3], which for its part identified a slightly longer average holding period of between 4 and 4.5 years, suggested advances in technology and the development of platforms have been a factor as it is now much easier for investors and their advisers to monitor performance and buy and sell funds.

To some extent, the prevailing short-term attitude of private investors is replicated among financial advisers. Although the average holding period recommended to clients is 4.3 years, as the right-hand chart overleaf shows, more than half (52%) of advisers recommend holding investments for less than four years.

[1] http://www.cebr.com/.
[2] http://awealthofcommonsense.com/2015/03/whats-considered-long-term-in-the-stock-market/.
[3] http://www.theinvestmentassociation.org//assets/files/research/2015/20150914-ams2014-2015-fullsurvey.pdf (Figure 61).

Charts 2 and 3: Investment period

Length of time invested



This could be because advisers are also recommending non-equity investments, such as bonds, or perhaps some feel the need to bow to client demands. Whatever the reasons, further work appears necessary to help investors and their advisers fully appreciate the value of holding equity investments for the longer term and so allowing compounding do its work.

Investment expectations

One of the starker conclusions of our study is that the investment expectations of many investors belong to a different era – one in which interest rates were routinely 5% and higher. Globally, the average minimum level of income private investors say they would like to receive is 9.1% per year while the minimum amount advisers want to generate for their clients is only marginally more realistic, averaging out at 7.9% per year

It is worth highlighting that these results are to some degree skewed by a relatively small cohort of investors with very high expectations. As the following chart shows, for example, 18% of advisers want an income of 10% while 7% are looking at a figure of 20% or more. In contrast, almost half (49%) have more reasonable expectations of an income of 2% to 5%. This is less true for consumers where 28% are targeting a return in the range of 2% to 5% while 16% aspire to 15% or more.

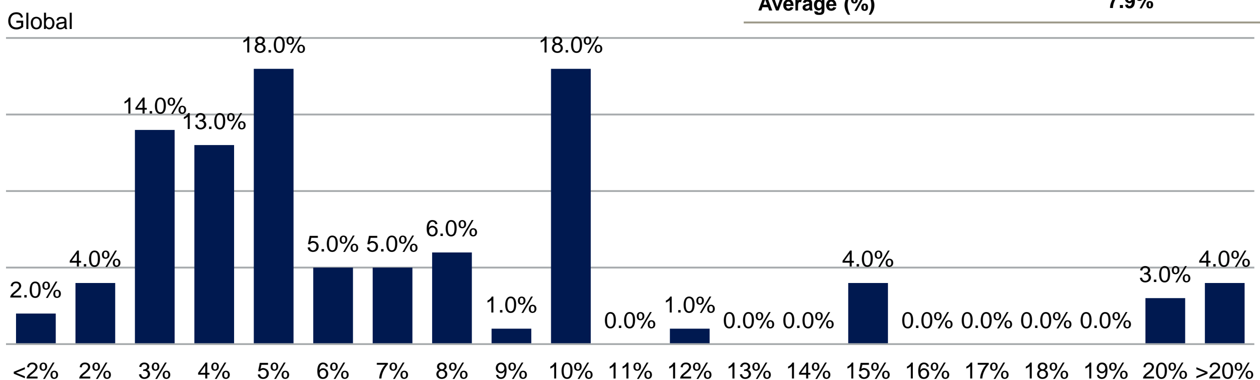
Chart 4: Investment income – advisers

Minimum desired level of income for clients

Thinking about the income your clients receive from their investments, (excluding cash savings and any properties), what is the minimum amount (as a percentage) you would like them to receive?

- The overall average level of desired income, Globally was 7.9%.
- This compared to a Global investors average (from the Consumer survey), of 9.1%.

Desired income	Global
Less than 10%	69%
10% – 14%	21%
15% – 20%	11%
Average (%)	**7.9%**



To offer some context to these income expectations, all the major markets – the UK, the eurozone, the US and Japan – have interest rates at 0.5% or lower. As of the end of May 2016, yields on the 10-year government bond were below 2% in both the UK and the US – and negative for the eurozone and Japan.

At the same time, the MSCI World index is yielding less than 3% and the FTSE All-Share less than 4%. Turning to the *Barclays Equity Gilt Study*[4] for a far longer-term view, more than 100 years' worth of data shows an average return from stockmarkets of 5.1% a year and an annual 1.2% from bond markets.

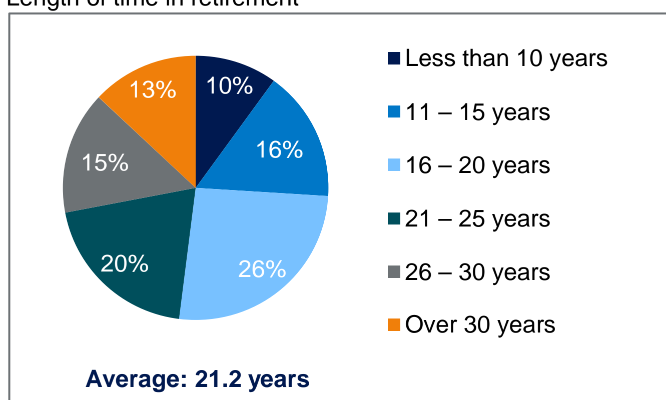
Clearly, investors and their advisers are wildly overestimating the returns they will be able to generate from their investments – a misapprehension that is likely to have a profound effect on long-term savings behaviour. After all, compounding at a rate of 9.1% a year for 20 years, savings of £200 a month will build up to a tidy £135,286. At a more realistic 4%, however, it only comes to £73,354.

Longevity expectations

In contrast to their hopes for annual income, our study shows people generally have much more realistic expectations as to how long they could live after retirement. As the chart below shows, the average response is a little over 21 years, with only 10% believing they could live for less than 10 years after retiring and 13% believing they could live for more than 30 years.

Chart 5: Life expectancy after retirement

Length of time in retirement



Taking the UK as an example, that average of 21 years is broadly in line with the most recent Office of National Statistics (ONS) report[5], which indicated men and women who reached the age of 65 between 2012 and 2014 could expect to live for an additional 18 to 20 years.

[4] https://wealth.barclays.com/en_gb/smartinvestor/better-investor/investing-lessons-from-114-years-of-data.html.
[5] https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/lifeexpectancies.

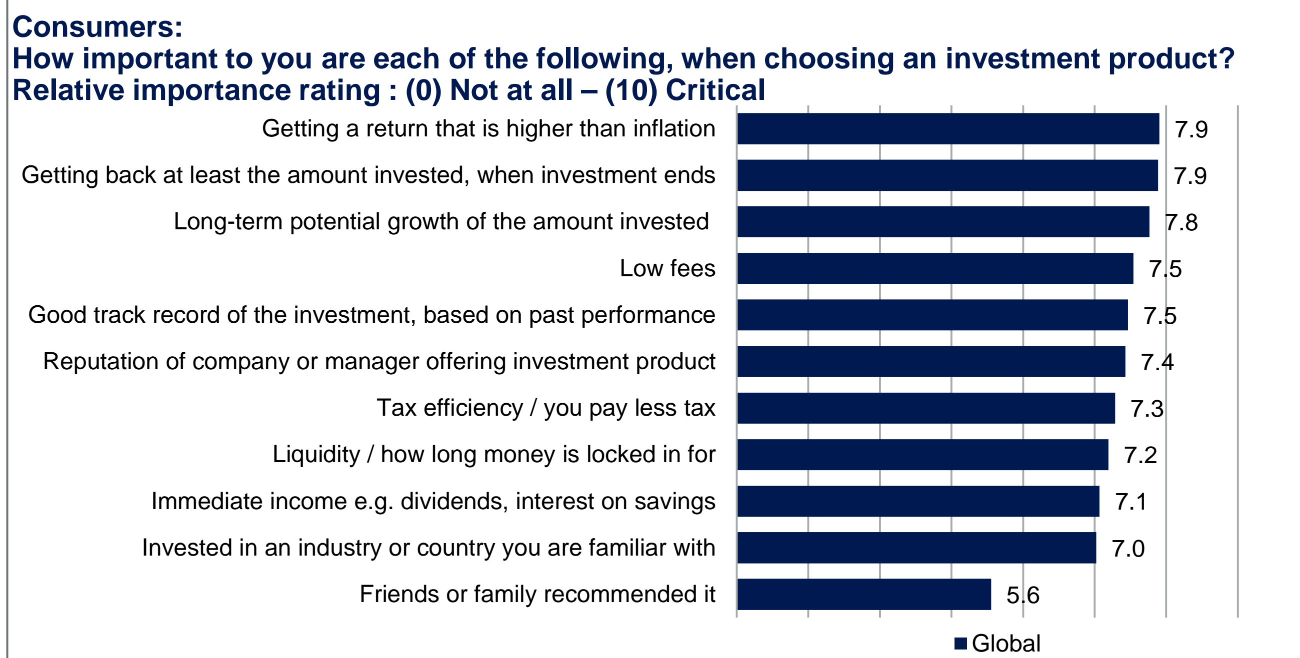
Reasons to invest

Consumers

At a time when the rates on savings accounts are, in many cases, negligible, a key reason to take on the additional risk of stock or bond markets is to beat inflation. Our study confirms investors share this view, with consumers ranking this and capital preservation as their joint most important reasons to invest. As the following chart shows, both scored 7.9 out of a possible 10.

Chart 6: Investment product drivers

Relative importance



Only marginally less important to consumers are growth (7.8) and low fees, which scores 7.5 – as does an investment's historic track record (no matter how much product disclaimers may protest otherwise). Perhaps surprisingly, at the other end of the scale, the immediate income available from an investment is seen as a relatively low priority, ranking ninth out of the 11 options respondents were offered.

Advisers

As might be expected from those charged with helping clients achieve their financial goals, our study shows advisers admitting broadly to similar priorities when recommending investment products. With a score of 7.9, capital preservation is the joint highest priority – this time alongside growth – while immediate income (6.4) is the lowest.

As with their clients, past performance (7.5) and the reputation of an investment management group (7.4) are important considerations when advisers pick investments, but low fees are less so – ranking ninth out of the list of 11 options.

The millennial difference

'Millennials', also known as 'Generation Y', tend to do things differently. According to the latest Deloitte Millennial Survey[6], for example, millennials – those born between the early 1980s and 2000 – think differently about corporations. Generally they mistrust 'big business' and, in a similar vein, they do not display the same loyalty to their employers as previous generations.

This presents a number of issues for investment managers. Not only are millennials less likely to be as willing to stick with investments over the longer term or to remain loyal to certain brands, but also their inclination to change jobs more frequently creates an extra hurdle for workplace saving. Such issues are put into sharp focus by the results of the 2016 Schroders Global Investor Study.

[6] http://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html

Thus, for example, our millennial respondents say that, on average, they hold their investments for in excess of a year less than their older counterparts (2.3 years versus 3.9 years) while two-fifths (41%) admit to having an investment timeframe of less than 12 months.

To some extent, this is understandable as their needs will feel more immediate – millennials are more likely, for example, to want to save for a house deposit, to provide for children or to supplement their salary or income. In contrast – though, again, as one might expect – thoughts of retirement income have yet to impinge much on their consciousness.

Generally speaking, millennials do prioritise the same investment characteristics as older investors – generating a return higher than inflation and capital preservation – and, on average, they do not expect to live a great deal longer than older investors after they retire (21.5 years versus 21 years).

They are, however, more likely to rely on non-pension income in retirement while perhaps the biggest discrepancy between them and older generations relates to the minimum level of income they would like to receive from their investments.

Millennials' average income expectation of 10.2% per year is, for example, significantly higher than the 8.4% of older investors. Furthermore, while a lot fewer (41% versus 60%) would be happy with less than 10% income, a much larger proportion (20% vs 13%) are harbouring hopes of an unrealistic annual income of 15% or more.

Conclusions

Until relatively recently, there had been a sense the exceptionally loose monetary policy adopted in response to the global financial crisis was a temporary phenomenon. Sooner or later, consensus ran, economic growth would pick up, interest rates would rise and some form of normality – in the sense, at least, of a pre-crisis policy environment – would return.

Eight years on though, such hopes appear increasingly forlorn. Interest rates may have been tentatively raised in the US but, with inflation still very low around the world, few countries seem in any hurry to follow the Federal Reserve's lead. Indeed, Japanese and eurozone policymakers remain firmly in easing mode.

If this is the new reality then, a significant number of investors have a painful process of adjustment ahead of them. With interest rates around the globe stuck below 1%, achieving an annual return of 8% or 9% is a near impossibility without taking on significant levels of risk. And with capital preservation a top priority, that course of action looks unlikely to be of interest to most investors.

The Schroders Global Investor Study 2016 paints a picture of a world in which investment expectations are stuck in a bygone era, which should be a concern for everyone involved in long-term financial planning.

Our findings suggest many investors do not realise how much they need to save or for how long. At the same time, with average holding periods still relatively short, the mantra that equity investing should ideally be a long-term undertaking is going largely unheeded.

All this represents a challenge for investment management firms, which must attempt the awkward balancing act of readjusting investor expectations while still convincing them of the benefits of long-term saving and investment.

Notes: About the Schroders Global Investor Study 2016

Schroders commissioned Research Plus Ltd to conduct, between 30 March and 25 April 2016, an independent online study of 20,000 investors in 28 countries around the world, including Australia, Brazil, Canada, China, France, Germany, India, Italy, Japan, the Netherlands, Spain, the UK and the US. This research defines 'investors' as those who will be investing at least €10,000 (or the equivalent) in the next 12 months and who have made changes to their investments within the last five years. These individuals represent the views of investors in each country included in the study.

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