


The case for global low volatility equity investing

For investors

Winning by not losing

While many investors will likely invest in equities because of their potential for attractive long-term capital growth, when equity markets fall, as they often do, the timing of this fall can have a major impact on your investment balance. Low volatility strategies are designed to help 'smooth the ride', giving equity investors the opportunity to earn meaningful investment returns while reducing the downside risk of their investment. This simply means that your investment in equities should be less volatile and, when the market falls, the percentage your investment falls will be less than the market.

While investing in equities should provide strong capital growth over the long term, the Global Financial Crisis (GFC) and COVID-19 pandemic highlight just how volatile markets can be. Figure 1 overleaf highlights over the past 30 years there have been numerous events that have caused market volatility – beyond these two large-scale events. And while markets usually recover to go beyond previous highs, whether or not an investor can absorb this volatility will depend upon their risk tolerance and investment timeframe. No one wants to be forced to sell when markets are low.

For investors who are approaching – or in – retirement, reducing downside risk is even more important than ever. Why? Let us explain by describing the concept of sequencing risk.

Sequencing risk explained

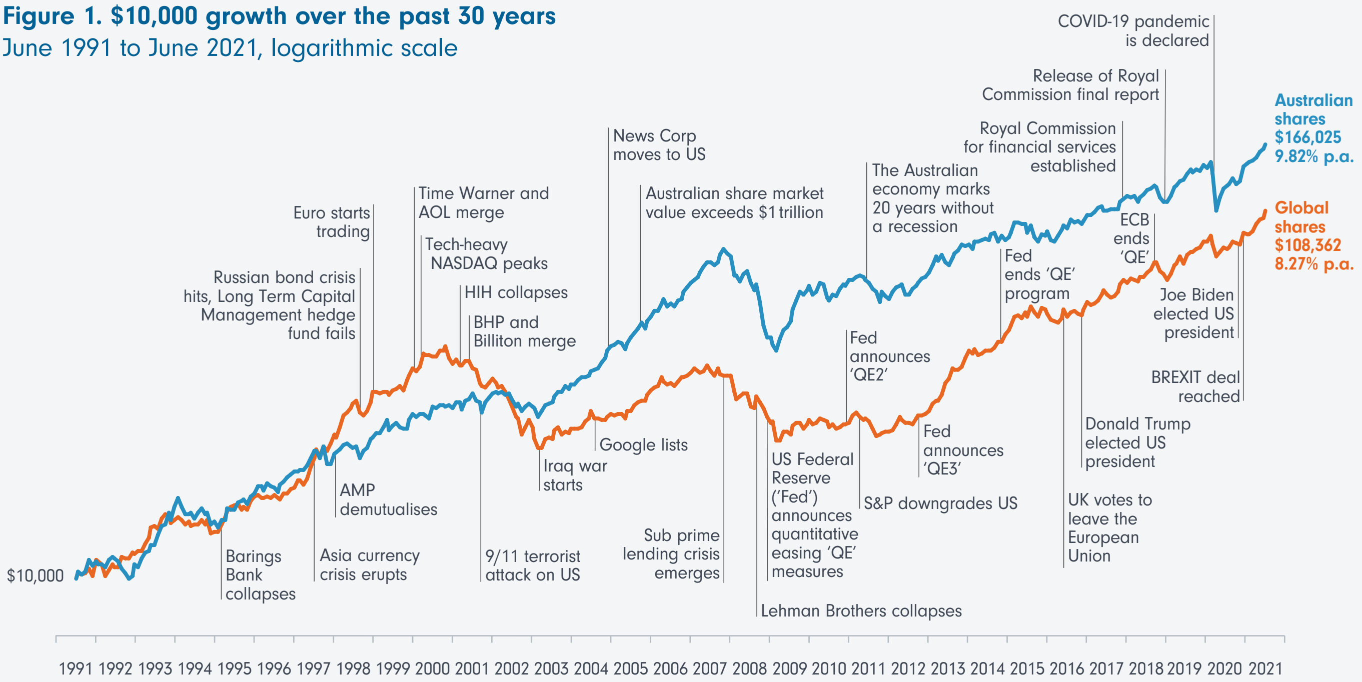
Sequencing risk linked to the idea of dollar cost averaging. With dollar cost averaging, you invest regularly and your regular contributions buy more shares when investments are down. For an investor who is accumulating assets, a negative sequence of returns early on in their investment timeframe can work to their advantage as they can buy more shares and earn more capital growth over time on their investment.

In retirement, however, while investors are selling shares to realise income – not buying them – they may need to do so when share prices are low. For retirees, a high proportion of negative returns in the beginning years of retirement will have a lasting negative effect and reduce the amount of income they can withdraw over their lifetime. Low volatility equity investing is a strategy designed to address this risk.

> Low volatility strategies are designed to help 'smooth the ride', giving equity investors the opportunity to earn meaningful investment returns while reducing the downside risk of their investment.

Thirty years in Australian and global shares

Figure 1. $10,000 growth over the past 30 years
June 1991 to June 2021, logarithmic scale



Source: Bloomberg. All returns shown are in AUD terms (assuming currency exposure is unhedged) and assumes dividends are reinvested. Returns are average annual returns over the periods shown. Indices used are: Australian shares: S&P/ASX 200 All Ordinaries TR, Global shares: MSCI All Country World Index NR. NR: NR at the end of the benchmark name indicates the return is calculated including reinvesting net dividends. The dividend is reinvested after deduction of withholding tax, applying the withholding tax rate to non-resident individuals who do not benefit from double taxation treaties. In the Australian and global shares chart, a semi logarithmic scale has been used to show the proportionate importance of fluctuations over the period. The base of the semi logarithmic scale is 8. Index performance does not take account of management costs, operational and transactional costs or tax. Index performance does not reflect the performance of any individual portfolio of stocks. Please remember past performance is not a guide to the future. Investments in overseas markets can be affected by currency exchange and this may affect the value of your investment.

Why low volatility equity investing?

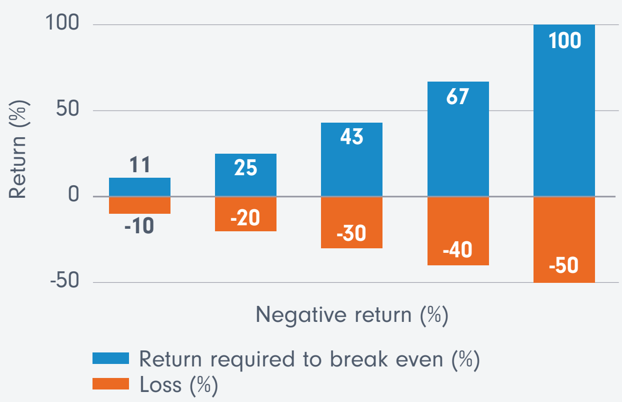
Low volatility equity investing is based on the premise that by losing less in down markets, investors can achieve the equity returns they seek, with lower volatility than the market. These funds invest in low-volatility stocks which typically fall less than other stocks in down markets.

And while investors may have to forgo some upside when markets rise, the capital preserved in down markets can have a material positive impact on returns over the long term. This is because protecting from losses, or reducing those losses, in falling markets leaves more capital to grow when markets rise again, contributing to faster recoveries and the potential to generate significant market outperformance through the power of compounding. Consider the following example, which explains the asymmetric relationship between gains and losses.

An example – the asymmetric relationship between gains and losses

As Figure 2 shows, a loss of 10% in the market requires a subsequent 11.1% gain to break even and recover the value that was initially lost. This asymmetry increases sharply as the loss increases; a 50% loss requires a subsequent 100% gain to break even. This is because of the way the mathematics of compound interest works and is often misunderstood.

Figure 2. Limiting the downside loss has a greater impact than participating in 100% of gains of the market



Source: Fidelity International, for illustrative purposes only.

The asymmetric relationship between gains and losses means that limiting losses during volatile markets has a more powerful effect on long-term growth potential than achieving the same nominal positive return.

Let's look at another example. From the low point of the GFC, when the MSCI World Index fell 30%, it took five years for the market to recover its losses. However, if an investor had realised only 50% of the loss of the MSCI World Index and then experienced 50% of the daily gains and losses of the index thereafter, it would have taken less than two years – 22 months – to recoup the market's losses.

This example shows that limiting the downside loss has a bigger impact on overall long-term returns than participating in 100% of the gains of the market.

The Fidelity Global Low Volatility Equity Fund

Many low volatility equity strategies in the market are based on quantitative historical data, which is backward-looking. Fidelity's Global Low Volatility Equity Fund uses a combination of both quantitative (backward-looking) and fundamental analysis (forward-looking) to assess the risk profile of a stock and build its portfolio.

Key features

A diversified, core portfolio of 100 to 250 global equities. It aims to achieve long-term capital growth with lower risk than the market.

Leverages insights from Fidelity's extensive global research platform, overlaid with sophisticated quantitative risk tools to build an optimal portfolio.

Aims to outperform the market with volatility of 60% to 80% of the MSCI World Index.

Access Fidelity's experience in managing low volatility funds

The managers of the Fidelity Global Low Volatility Equity Fund have a proven track record in managing a comparable low volatility strategy in the US over the past nine years. With a long-term track record of outperforming its peers in the US market, this Fund was launched in the Australian market in December 2017.

> " People sometimes think that defensive strategies only really deliver in a market crisis, but that isn't the case. This strategy has performed well in small corrections and participated nicely when markets appreciate. It's about providing a smooth ride over time and protecting capital when markets go down, whether it be a lot or a little. "

Benjamin Treacy
Institutional Portfolio Manager

Like to know more?

If you'd like to know more about the Fidelity Global Low Volatility Equity Fund, visit our website, or call or email our client services team:

Telephone
1800 044 922

Email
auclientservices@fil.com

Website
fidelity.com.au

09/2021