Understanding asset class performance

Building a better block chart

Many investors are familiar with the "quilt-block" chart – featuring rows of colorful blocks that illustrate the performance of different asset classes year by year. These charts may be handy as an overview of yearly asset class performance. But reconstructing these charts with a long-term view can reveal some important insights into the economic drivers of asset class performance.

The long-term view

At first glance, the chart below may look like the traditional quilt-block chart, but we've reconstructed it to take a long-term view versus a year-by-year view. See the back page to find out more.

The importance of diversification

	1929-1941 (13 Years)	1942-1965 (24 Years)	1966-1981[1] (16 Years)	1973-1981[1] (9 Years)	1982-1999 (16 Years)	2000-2016 (17 Years)
Market environment %	Deflation	Low-inflationary growth	Inflation	Inflation	Low-inflationary growth	Deflation-like[2]
Highest return	Corporate bonds 6.06	Stocks 15.70	Inflation 7.00	Commodities 12.81	Stocks 18.52	Corporate bonds 7.70
↑	Long-term government bonds 4.55	Inflation 3.06	T-bills 6.83	Inflation 9.22	Corporate bonds 12.17	Long-term government bonds 7.35
	T-bills 0.79	Corporate bonds 2.45	Stocks 5.95	T-bills 8.23	Long-term government bonds 12.08	Stocks 4.51
	Inflation -0.79	Long-term government bonds 2.11	Corporate bonds 2.89	Stocks 5.16	Commodities 9.00	Inflation 2.18
↓	Stocks -2.43	T-bills 1.70	Long-term government bonds 2.53	Corporate bonds 2.49	T-bills 6.23	T-bills 1.65
Lowest return	Commodities index was not incepted[1]			Long-term government bonds 2.49	Inflation 3.29	Commodities -0.80

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1 Inception of the Commodities Index was 1973. From 1973-1981 the commodities asset class was the only asset class that provided meaningful returns above inflation.

2 This period did not represent a true deflationary period because consumer prices did not fall. However, there were dislocations in credit to the upside and downside during the decade. The reductions in credit supply that occurred in the early and later part of the decade led to economic contractions similar to what would be experienced in a deflationary environment.

Stocks may decline in response to investor sentiment, general economic and market conditions, regional or global instability, and currency and interest rate fluctuations. Fixed income products, such as corporate bonds, are subject to the effects of changing interest rates. Obligations issued by US government agencies and instrumentalities may receive varying levels of support from the government, and Treasury bills and long-term government bonds would be affected should they default. Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds.

The changes

Our chart shows the annualized performance of various asset classes from 1929 through 2016. But instead of showing performance by calendar year, we divide our data into six time periods reflecting five distinct market environments. Examining the data in this form, it's easy to see historical trends.

- **Deflation.** Bonds led the way in the deflationary environment of 1929 to 1941. They led again from 2000 to 2016, when credit supply reductions created a deflationary-like environment.
- **Inflation.** In the inflationary years of 1966 to 1981, T-bills outperformed stocks, and both of those asset classes trailed the inflation rate. Data for the commodities index became available in 1973, in the midst of that inflationary period. Starting then, commodities led the way for nine years and were the only asset class that provided meaningful returns above inflation. It's important to note that commodities generally are volatile and are not suitable for all investors.
- **Low-inflationary growth.** Stocks were the clear leaders in the low-inflationary growth periods of 1942 to 1965 and 1982 to 1999.

This is important knowledge because — rather than trying to position a portfolio for the coming calendar year — investors should be focusing on constructing a long-term portfolio that can withstand a variety of economic environments — especially if those environments persist for several years. What's more, seeing the data in this context may correct some misperceptions that many investors have.

- **"It's 'normal' for stocks to outperform."** In general, baby boomers began seriously investing during the low-inflationary growth period of 1982 to 1999, when stocks outperformed. We may all hope to see a 20-year equity bull market again, but such a market may not happen precisely when you need it to. You need to make sure you have a plan you can live with if equity market returns turn out worse than you're hoping for.
- **"Equities are the best inflation hedge."** This is a common adage among investors, but historically, the situation is a bit more complicated than that. Equities have tended to perform well once inflation has made its way into the system, but they have underperformed at the onset of inflation. As the chart shows, that initial underperformance caused stocks to lag commodities and T-bills over the course of the inflationary environment shown. And, while it's possible to find slices of the market that outperformed inflation, we believe that for most investors, overweighting a portfolio toward a small segment of the stock market may just increase downside risk along with any upside returns.

Talk to your financial professional

One of the keys to portfolio construction is to understand the risks of investing in various economic environments, which our reconstructed quilt-block chart helps illustrate. Talk to your financial professional about how to prepare your portfolio so that, no matter which economic environment comes, you may be better covered.

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All data provided by Invesco unless otherwise noted.

Stocks are represented by the S&P 500 Index; inflation by the Consumer Price Index (CPI); commodities by the S&P GSCI Index; long-term government bonds by the Ibbotson U.S. Long-Term Government Bond Index; T-Bills by the Ibbotson U.S. 30-Day T-Bill Index; and corporate bonds by the Ibbotson U.S. Long-Term Corporate Bond Index. The S&P 500 Index is an unmanaged index considered representative of the US stock market. The CPI is a measure of change in consumer prices as determined by the US Bureau of Labor Statistics. The S&P GSCI Index is an unmanaged world production-weighted index composed of the principal physical commodities that are the subject of active, liquid futures markets. The Ibbotson U.S. Long-Term Government Bond Index is an unmanaged index representative of long-term US government bonds. The Ibbotson U.S. 30-Day T-Bill Index is an unmanaged index representative of 30-day Treasury bills. The Ibbotson U.S. Long-Term Corporate Bond Index is an unmanaged index representative of long-term US corporate bonds. An investment cannot be made directly in an index. Diversification does not guarantee a profit or eliminate the risk of loss.

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