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A look at the long-term data

For the past twenty-five years, academics Elroy Dimson, Paul Marsh and Mike Stanton (DMS) have published long-term asset return data that goes back over 150 years in some cases. This includes for equities, bonds and property, across around 35 countries including New Zealand. In the 2024 edition , key research findings DMS have made over the past decade using the data were summarised. Below we pick out some of these key findings and their implications for client portfolios.

Key findings from long term financial markets data

1.   Equities have outperformed bonds and bills (cash) in every country since 1900. They have also handily beat inflation in most cases, and by around 6% per annum globally. This is in line with the basic investment tenet that risk and return are related and informs our view that investors – subject to their risk tolerance and time horizon – should allocate as much as possible to growth assets.

2.   Investment grade corporate bonds have outperformed government bonds by around 1% per annum over the long run, while high yield bonds have outperformed by around 3%. Again this reflects the expected relationship between risk and return, and motivates allocating to both corporate and government bonds in client portfolios.

3.   Emerging market (EM) equities have underperformed developed markets (DMs) since 1900, but this mostly reflected their worse performance in the 1940s. Despite this the historic gains from spreading assets across DMs and EMs are substantial. The typical DM investor can reduce risk by holding EM equities and vice-versa.

4.   A large number of stocks across both countries and sectors are required for effective diversification given many countries' equity markets are dominated by a small number of sectors (and some sectors are dominated by a small number of companies). For this reason, investors in most countries over the past 50 years would have had superior risk-adjusted returns (before tax) investing globally than in their home market alone. The one notable exception to this was for the US investor, but even so the authors caution against just investing in US stocks (discussed further below). These findings are in line with our view that the core of the equity part of portfolios should consist of funds that invest across hundreds of securities across global equity markets.

5.   Finally, as illustrated over the page there have been massive shifts in both the country compositions and sectoral compositions of global equity markets. At the beginning of the 20th Century the US constituted only around 15% of global market capitalisations, many emerging market exchanges didn't exist, and Western Europe and Russia accounted for around 75% of the global market. Today, the US dominates at over 60% and European country exchanges are in the low single digits. In 1900 railway stocks were around 60% of the

US market and 45% of the UK stock market. Today they do not feature as a major sector in either country, whilst technology in particular has become a major sector.

Given all of these shifts it is tempting to think that allocating to sectors or countries that are on the rise could provide superior performances. But again DMS caution against this. Their research suggests that, if anything, markets tend to over-price sectors on the rise, and investors would have been better off allocating to sectors on the wane. The allocation we make to equity funds that incorporate 'value' as a factor effectively replicates this. They typically underweight the in-favour expensive sectors and over-weight out of favour cheap sectors and stocks.

The same conclusion holds for countries. The US market has been exceptional, but so was Japan from post WW2 to the early 1990s where its market capitalisation topped out at 45% of the global market. From 1990 to 2023 Japan had the worst performing market and its global market cap weight is now only around 6%. This is not to say that the US market and tech stocks are necessarily in for a long period of under-performance like Japanese stocks. But it is a risk given the extraordinary run of the US market and its now large concentration in large cap technology stocks like Google, Nvidia and Apple. As mentioned, we guard against this risk by allocating globally with a bias to value and smaller cap stocks.

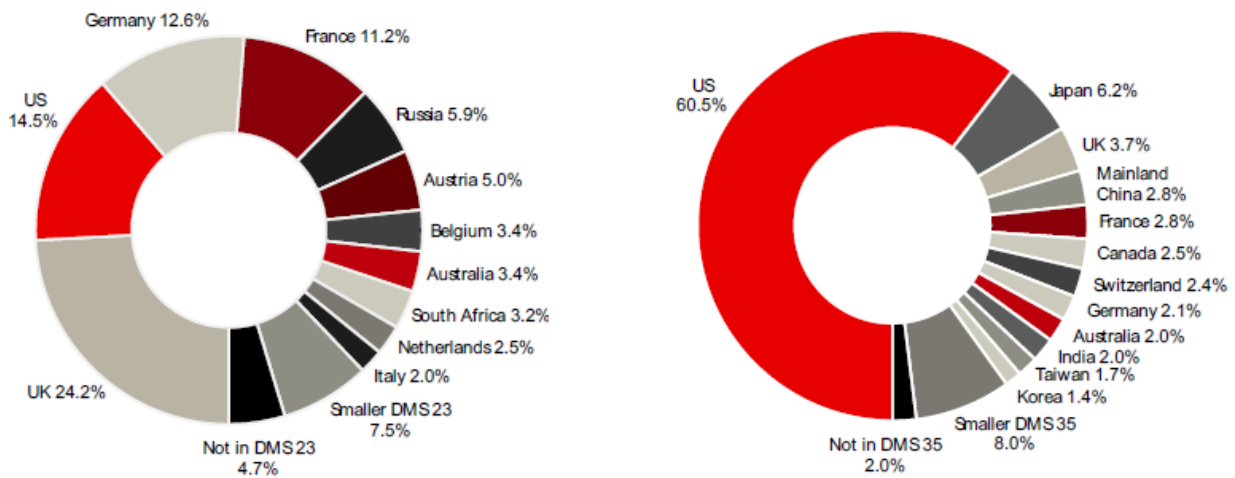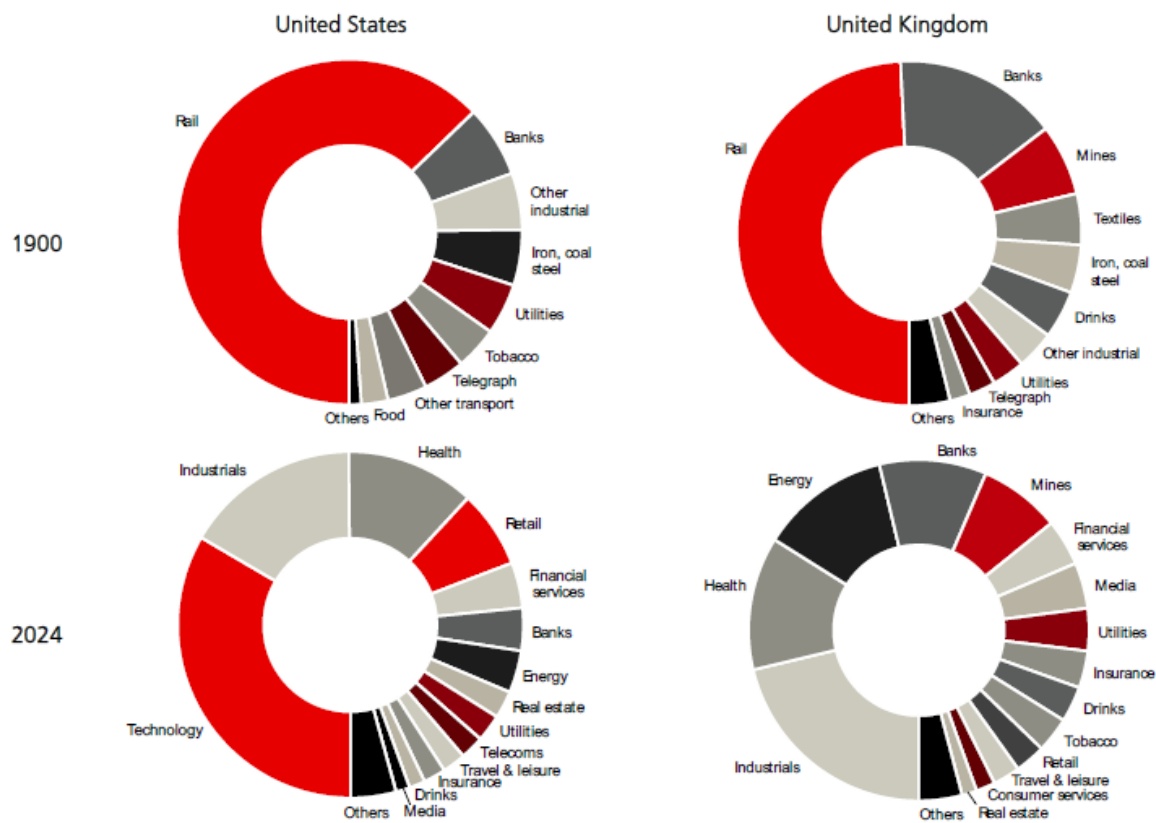Figure 3: The country compositions of markets in 1899 (left) versus 2024 (right)

Figure 4: The sector compositions of markets in 1900 (top) versus 2024 (bottom)

Sources: Elroy Dimson, Paul Marsh and Mike Staunton, DMS Database 2024; Cowles, 1938, FTSE Russell All-World Index Series Monthly Review, December 2023.