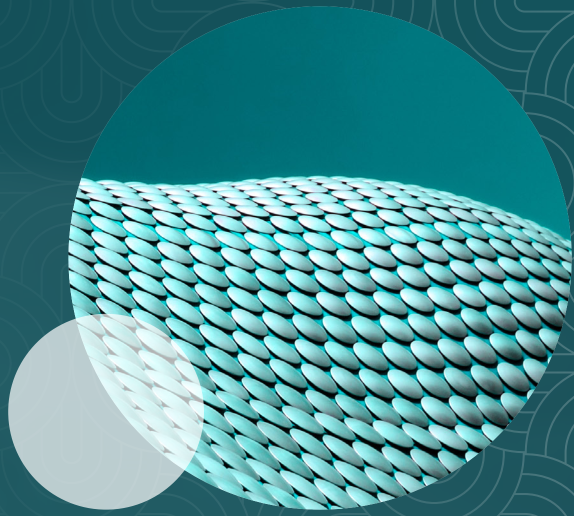
Performance paths

The importance of base effects and a meaningful time frame



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Your retirement and savings are invested in financial markets. The value of your savings is linked to what is happening in financial markets. In recent years, financial markets have been extremely volatile.

Volatility represents the upward and downward movement of financial markets and how drastically they could swing up and down. Markets that perform well help grow your savings. Markets that perform poorly erode your savings.

The performance of financial markets, along with the value of your savings, is reported over a specified period (for example monthly or yearly or over a number of periods combined). The problem with this is that these performance numbers are as much a function of the latest month's performance data as it is the dropping off of the first month's performance data. That's because the reporting timeline moves onto the next month, and then the next month and then the next month after that.

This note illustrates the point by looking at market returns for South African equity on the FTSE/JSE All Share Index from 1 February 2021 to 31 January 2024 over:

one month and **one year**

Investment Solutions
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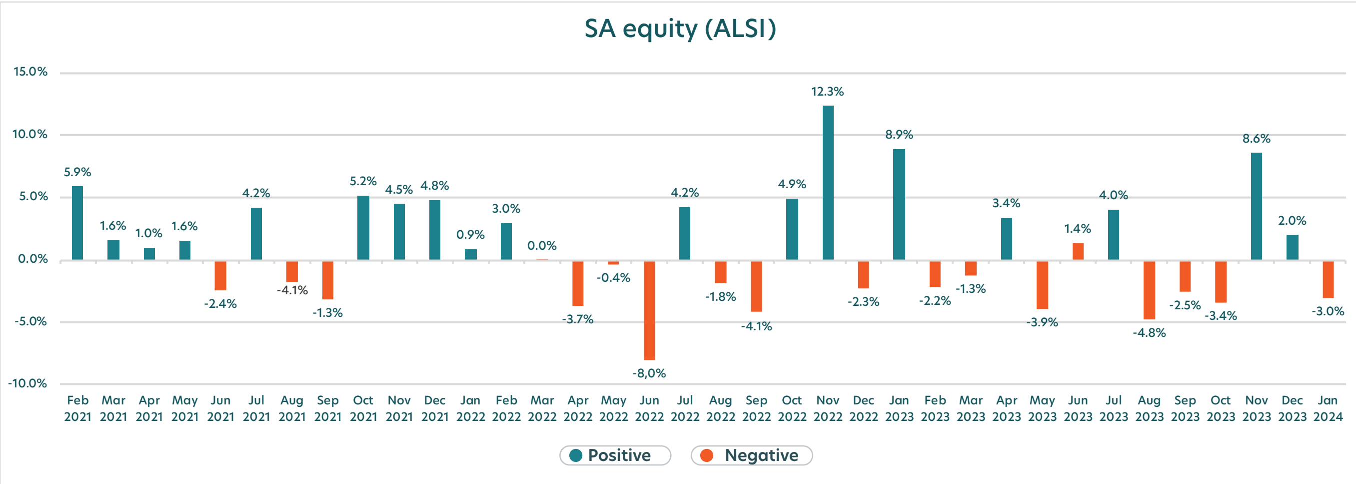
Monthly returns

Medium-risk to high-risk portfolios have a higher exposure to growth assets like equities, also known as 'shares'. Buying equities means buying shares or part of a company in the hope that the value of the company will increase over time. This asset class has the potential for higher investment returns over long periods, but their value can rise or fall over short periods. Experience shows that although the value of growth asset classes like equities can change often and quickly compared to other types of investments, they can provide investors with a greater chance of beating inflation over time, which helps retirement savings keep up with the cost of living.

Chart 1: SA equity market monthly returns from 1 February 2021 to 31 January 2024

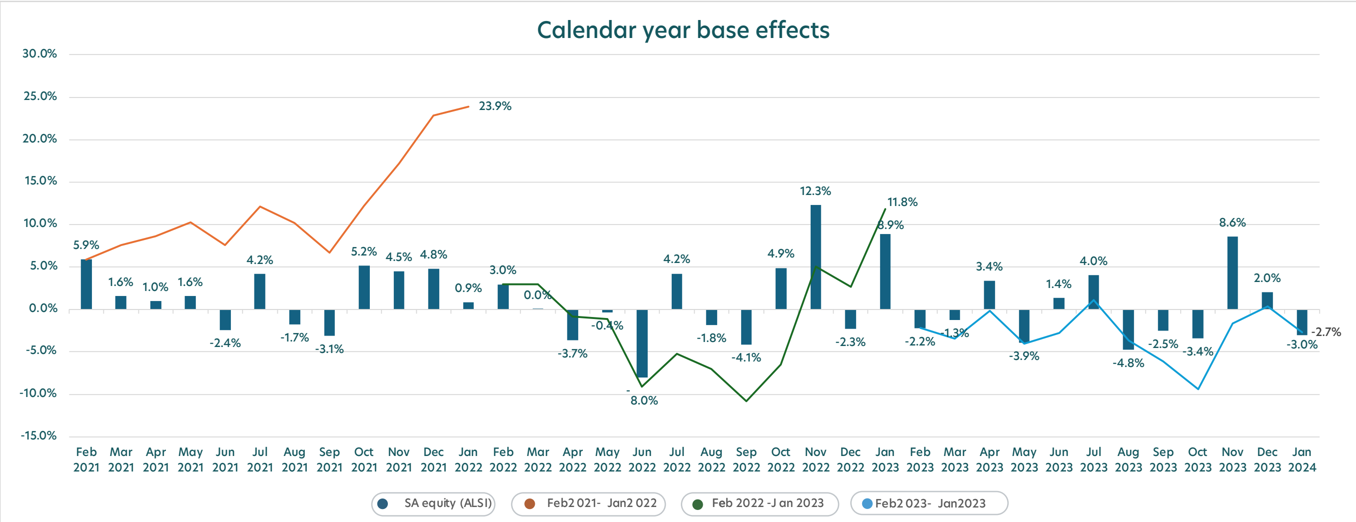


Source: Alexander Forbes Investments

SA equity market returns have been volatile since 2021.

One-year returns

Chart 2: SA equity market monthly returns (represented by the bars) **and combined one-year returns** (represented by the lines)



Source: Alexander Forbes Investments

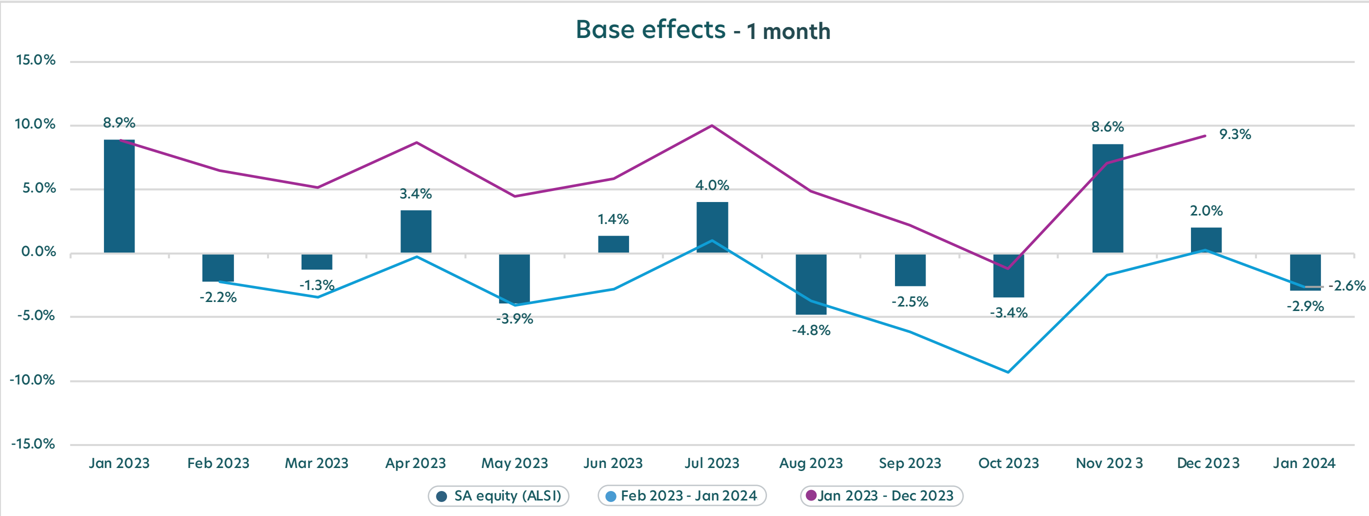
The chart shows that the one-year returns have changed significantly over the last three years. This is because each one-year return is a function of 12 months' performance numbers based on events that happened in that specific year. For example, the return of the SA equity market to 31 January 2022 experienced a number of months with positive performance and delivered a few months of negative performance, posting a strong double-digit return of 23.9% over the period.

Similarly, the return of the SA equity market to 31 January 2023 experienced a number of months with strong positive performance to deliver a return of 11.8% over the period, despite some months of significant negative performance. However, the one-year return of the SA equity market to 31 January 2024 experienced a number of months of negative performance and delivered a few months of flat-to-positive performance, posting a negative return of -2.6% over the period.

Why is this important?

Investment performance over short periods can shift wildly as reporting timelines move.

Let's explore how adjusting our reporting timeline by just one month can significantly impact the perceived investment performance over a 12-month period. The below chart illustrates this point comparing the one year return from January 2023 to December 2023 with the one year return from February 2023 to January 2024.



Source: Alexander Forbes Investments

When comparing the 12 months' performance ending December 2023 to the adjusted period ending January 2024, we observe a notable shift in results. The original 12 months' performance, concluding in December 2023, showed a return of 9.3%. However, by moving the reporting timeline by just one month, the 12 months' performance ending January 2024 displays a return of -2.6%. What causes such a stark contrast? Enter the concept of 'base effects' in investment reporting.

Base effects come into play when specific months, like a particularly positive January in 2023, are included or excluded from the reporting period. In our example, by shifting the timeline, we exclude that positive month, causing the overall return to plummet. This phenomenon illustrates how the starting point or 'base' of a reporting period analysis can influence return outcomes, painting a significantly different picture of investment performance.

It's crucial for investors to be aware of these base effects, as they can create variations in reported performance figures based on the chosen time frame. Understanding how the inclusion or exclusion of specific months can impact the overall results provides a more accurate perspective on investment performance.

It is important to note that the one-year returns can change significantly over a short space of time. It is, therefore, important, to focus on longer-term returns like five or ten years before making any decisions on or changes to your savings.

What investors should consider

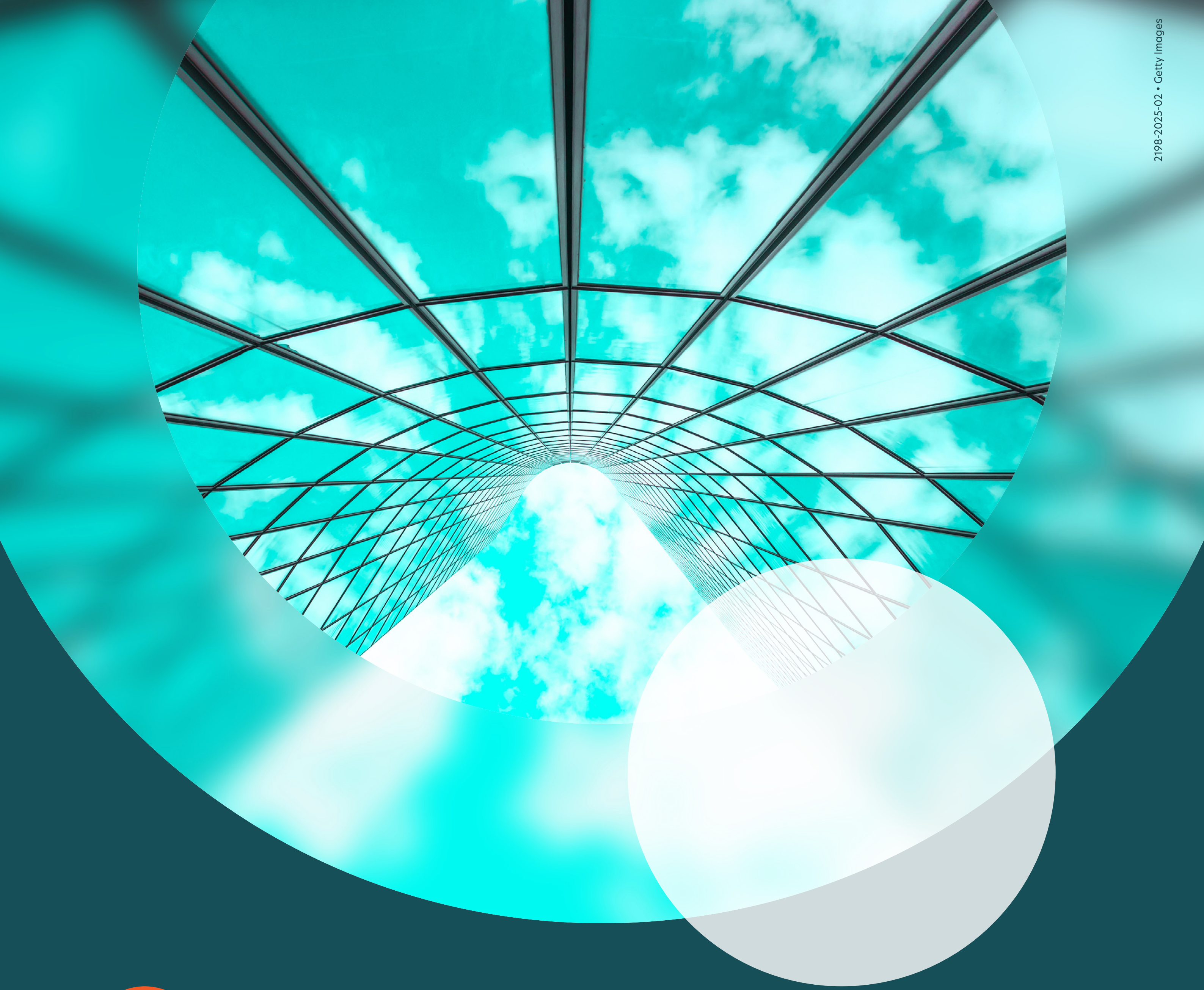
The reality is that different portfolios require different time frames for their performance potential to manifest. Ideally, investors evaluating portfolio performance would need to look at a portfolio's full performance data history in order to make any meaningful assessments of its actual performance delivery.

Performance can shift wildly because of events that may have happened one, three, or five years ago. Unless investors can assess the full performance history of a portfolio, it is very difficult to evaluate its 'bigger picture' performance path. For instance, a portfolio's performance path could have been lumpy. It could have experienced a number of years of bad performance and only recently delivered a short burst of great performance - and this 'wild ride' may not be evident in the headline numbers or in specific snapshots in time.

Once investors have aligned themselves with a portfolio that meets their needs and risk budget, it is important to understand the time frame it requires to reflect its performance potential and allow enough time for it to deliver. Taking a longer perspective on performance shows what an investment has or would have achieved over a period. This is helpful, in that you can get a better sense of how well your investments are performing, and if that level of performance is within reasonable expectations. A good rule of thumb is to use a longer time frame as a portfolio's objectives become more ambitious.

Before fear takes flight, we want to remind you to allow the ups and downs to run their course and to give your savings time to go through the motions and deliver on their long-term objectives. In times of uncertainty, our team is here to provide support and answer any questions you may have. If you're a investor and need guidance or clarification, please feel free to reach out to your financial adviser. We value your trust, and together, we'll navigate through the market's twists and turns, ensuring that financial objectives remain on track.

Stay confident, stay informed, and don't hesitate to get in touch if you need assistance.



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Get advice before you act

It's easy for investors to get emotional about their life savings. Remember to contact your accredited financial adviser should you have any questions or concerns. This will ensure you always have the correct information to make an informed decision about your investments.

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