Seed Weekly

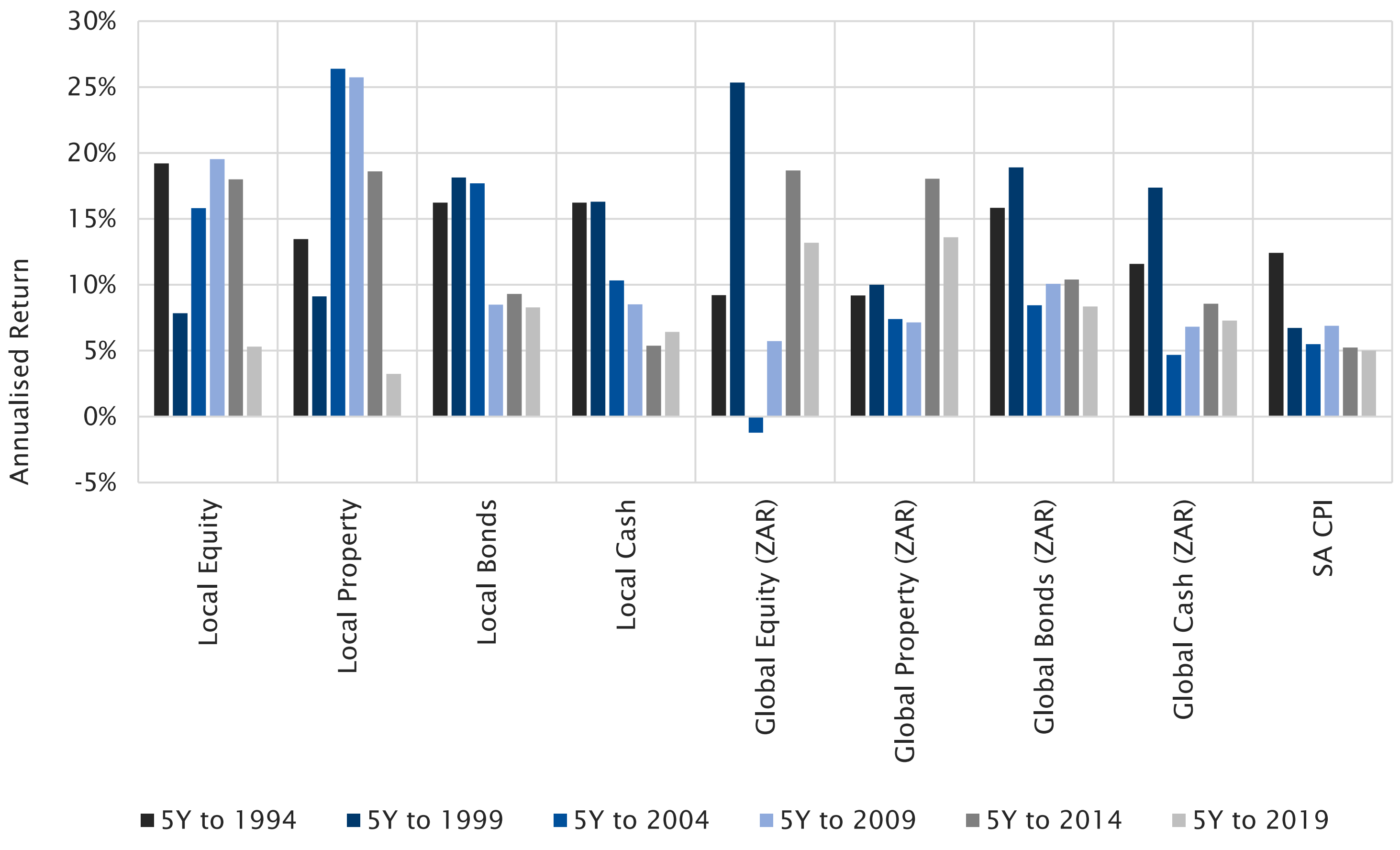
30 October 2019

Long Term Asset Class Returns Revisited

An important part of Seed's multi management process is to perform monthly asset class valuations using our in-house quantitative models. This process covers all the local and global asset classes that are suitable for inclusion in our multi asset class funds and model portfolios. The output of these models guides our tactical asset allocation decisions, where we under- or overweight certain asset classes in the short term, compared to our longer-term Strategic Asset Allocations.

In order to establish and review the Strategic Asset Allocations for our portfolios, we track the long-term returns of the various asset classes. This means building up a dataset going back as far as possible, and today we will analyse rolling 25-year data going back 30 years. Listed Property as an asset class has not been around that long, and our 30-year history is a combination of 17 years' worth of official index returns and 13 years of estimates received from specialist listed property managers.

The chart below illustrates annualised returns from the various asset classes over distinct 5-year periods since 1989. Except for Local Cash, the returns over the last 5 years have all been lower than over the preceding 5-year period. Local Equity and Local Property have delivered very low returns of 5.3% and 3.2% respectively, significantly lower than all previous 5-year periods.



These 5-year intervals can be grouped together to form two 25-year periods, running either from 1989 – 2014 or 1994 – 2019.

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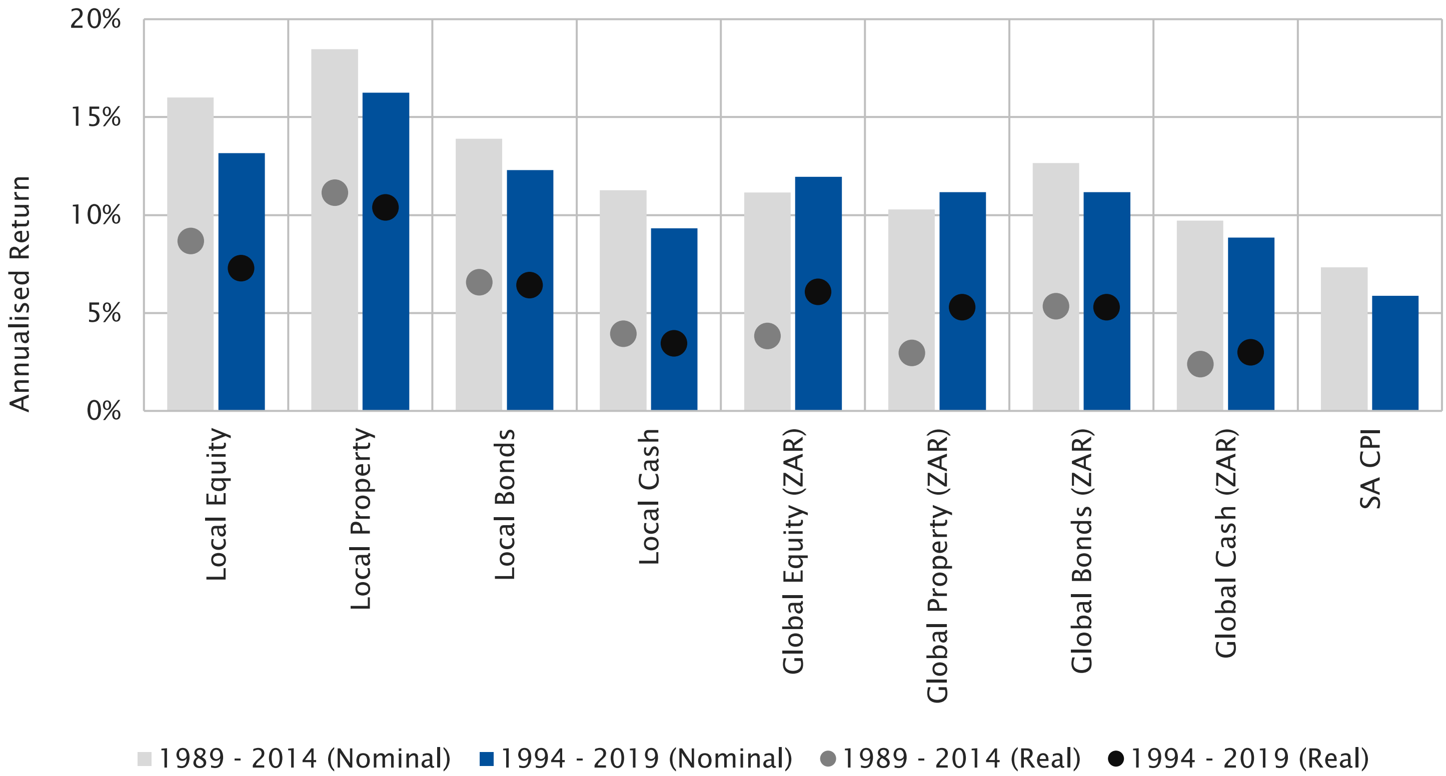
The chart below compares the latest 25-year snapshot to the one taken 5 years ago, which is as far back as we can look using this dataset. Given that the last 5 years have been a low-inflation environment, the chart also includes the real return (i.e. the return achieved after taking account of inflation).



For all four local asset classes, the long-term returns have shifted lower in both nominal and real terms. For the growth asset classes – Equity and Property – the latest real numbers are 1.4% and 0.8% lower respectively, while the differences are smaller for Bonds (-0.2%) and Cash (-0.5%).

The real returns for global asset classes have improved in rand terms – significantly so in the case of Global Equity (+2.3%) and Global Property (+2.3%).

But what about volatility? Our research indicates that the risk profile of strategies and asset classes stay much more consistent than the return profile over time. The chart below plots the major asset classes in risk-return space.

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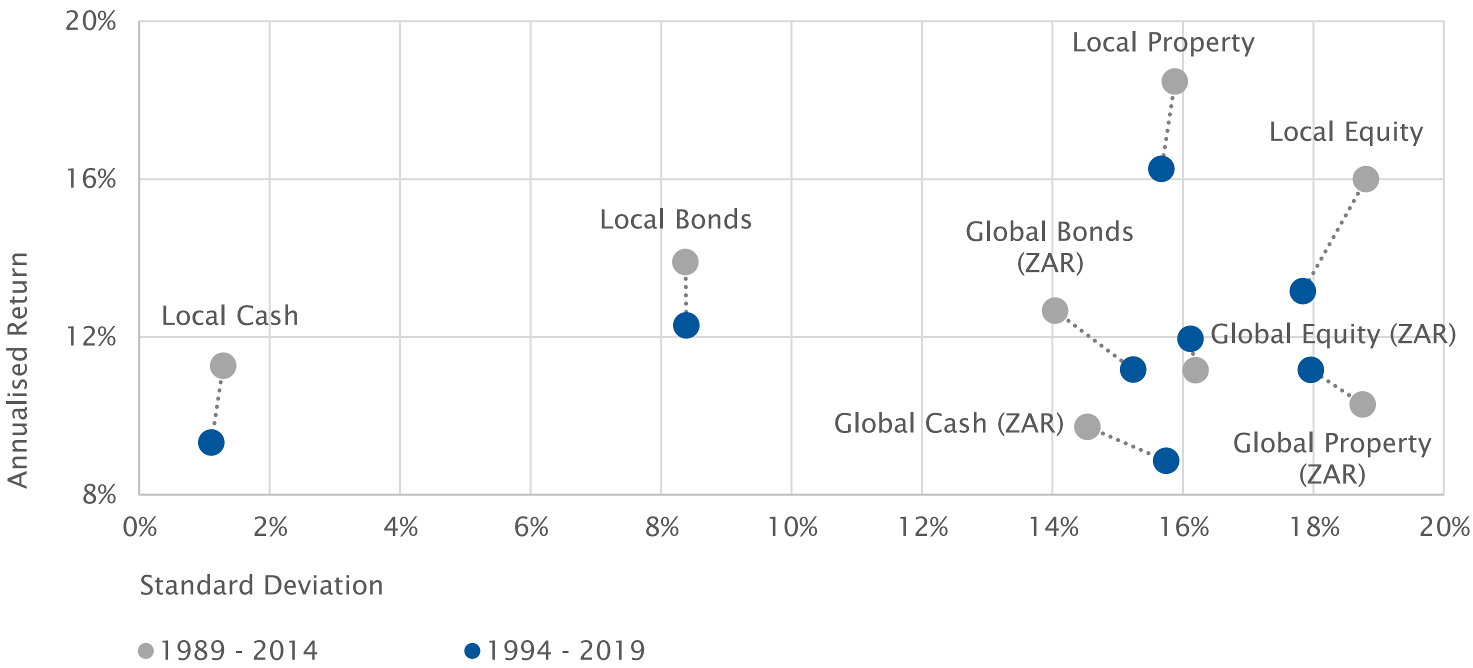

Commensurate with the lower returns, all four local asset classes were less volatile over the latest 25-year period. However, Global Equity and Global Property produced higher returns at lower levels of risk, while conversely Global Bonds and Global Cash delivered less at higher volatility.

All considered, an updated portfolio optimisation exercise using long-term returns would upweight Global Equity and Global Property at the expense of their local counterparts.

Given the long-term nature of these returns, we realise that it will take significant periods of 'outlier' performance, either positive or negative, to shift the averages significantly. However, Behavioural Finance teaches us that investors tend to overreact to short-term events and underreact to more gradual long-term changes. Therefore, while asset class characteristics will not change overnight, it pays to keep an eye out for movement in the long-term numbers.

Kind regards,

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Portfolio Manager

Chart source(s) : Seed Investments (30 September 2019)

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GLOSSARY OF TERMS

Annualised Return Annualised return shows longer term performance rescaled to a 1 year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.

Annualised Volatility The deviation of the calendar month return stream, since launch, relative to its own average.

Highest and Lowest Annual Return The highest and lowest returns, since launch, for any rolling 1 year period have been shown.

Maximum Drawdown The maximum calendar month peak to trough loss, since launch, suffered by the Fund.

NAV The net asset value (NAV) represents the assets of a Fund less its liabilities.

Positive Months The percentage of calendar months, since launch, where the Fund has delivered a positive return.

Return Horizon Minimum investment period to have a reasonable probability of receiving the benchmark return.

Risk Horizon Minimum investment period to have a reasonable probability of receiving a positive nominal return.

Total Expense Ratio (TER) The Fund's Total Expense Ratio (TER) reflects the percentage of the average NAV of the Fund that was incurred as charges, levies and fees related to the management of the Fund. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.