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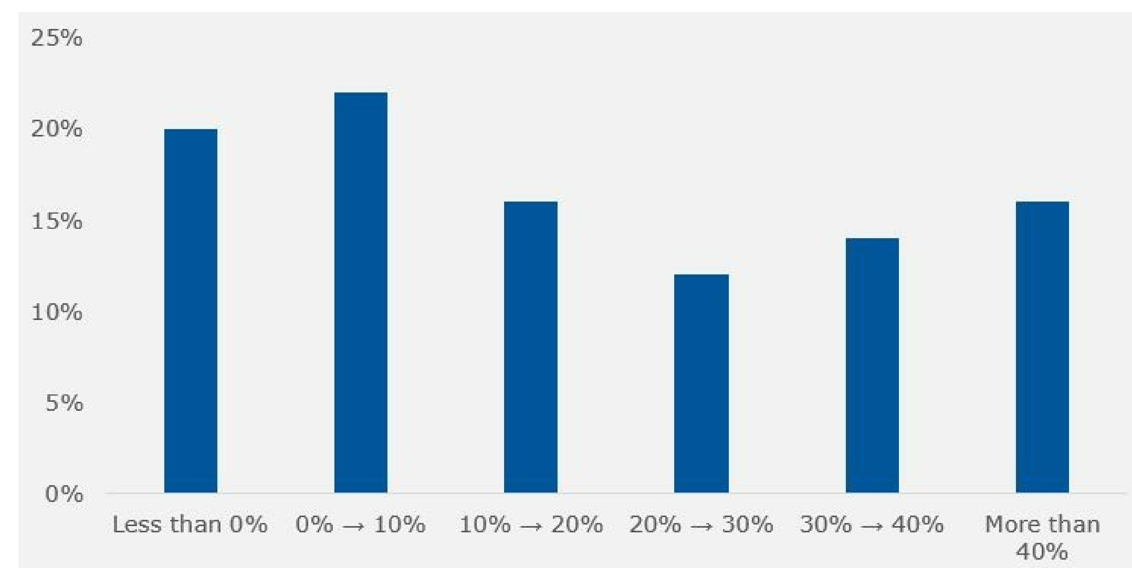
Market Expectations

Over the past 50 years the South African equity market (as represented by the FTSE/JSE All Share index - ALSI) has generated a compound return of 16.8% per annum (in ZAR) and over this same period the United States equity market (as represented by the S&P 500 index) has generated a compound return of 10.0% per annum (in USD).*

Most investors and advisors are aware of these general levels. Expectations are therefore that, over time, the ALSI should deliver returns in the mid-teens and the S&P 500 will return high single to low double digit returns. The problem with these expectations is that they often result in investors demanding these returns **EVERY** year, so when a year like 2022 comes along investors are incensed at the returns they receive.

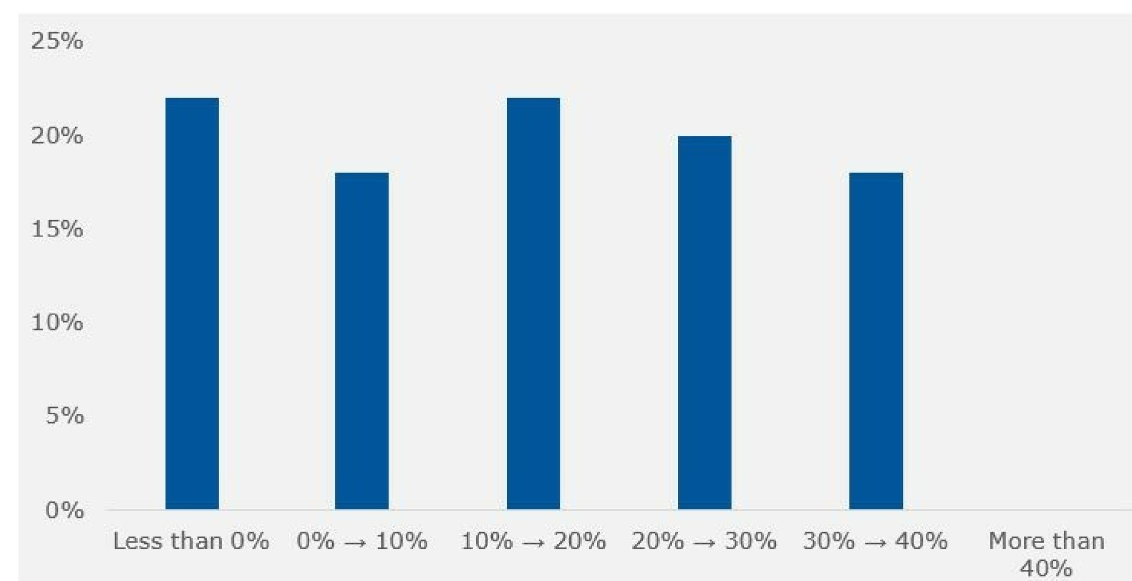
The reality when looking back at the past 50 calendar years is that the ALSI has produced negative returns 10 times (i.e. 20% of the time) which is more frequent than it has produced returns around its average (10% - 20%) - which it has delivered 8 times (16%). On the flip side, the ALSI has produced returns in excess of 30% (i.e. double the average or more) 30% of the time. The chart below shows the distribution of calendar year returns over the past 50 years, and over this period there isn't a clear trend.

Chart 1 : Frequency of ALSI Calendar Year Returns (1973 - 2022)



Therefore, over 1 year periods, rather than expecting to get 'regular' market returns, investors should expect to get 'non regular' market returns – i.e. either materially higher or lower than the long term average return. The trend is very similar to the S&P 500 – and I would imagine most equity markets around the world.

Chart 2 : Frequency of S&P 500 Calendar Year Returns (1973 - 2022)



As your investment horizon starts to extend, so the likelihood of earning an 'average' annual return starts to increase. Investors with a 3 year horizon have received an average return nearly 40% of the time (and only twice received a negative return) and over 5 years average returns are received nearly 50% of the time (with no negative returns).

It is for this reason that it is always stressed that investors should ***match the amount of risk taken in their portfolio with their investment horizon***, and for those investors in portfolios that have a large allocation to equities, an investment horizon of 5 years or longer is appropriate.

Another aspect not directly covered, is that investors should expect drawdowns on their capital during any period if they are invested in risk assets. Double digit equity market drawdowns on an annual basis should be expected (even in periods where overall returns are high). It is only through risking capital, and experiencing drawdowns that investors are able to earn material inflation beating returns over time.

Managing expectations is an important part of any investment process, whether looking at your own investments, or whether you're assisting someone else with their investments. Investors have a higher probability of staying the course where expectations are correctly calibrated at the start. 'Non normal' returns and double-digit drawdowns should be an important part of the conversation when investing for the long term.

**As an aside, the S&P 500's compound return in ZAR has been 17.0% pa, so on a like for like basis they have performed largely in line with one another.*

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