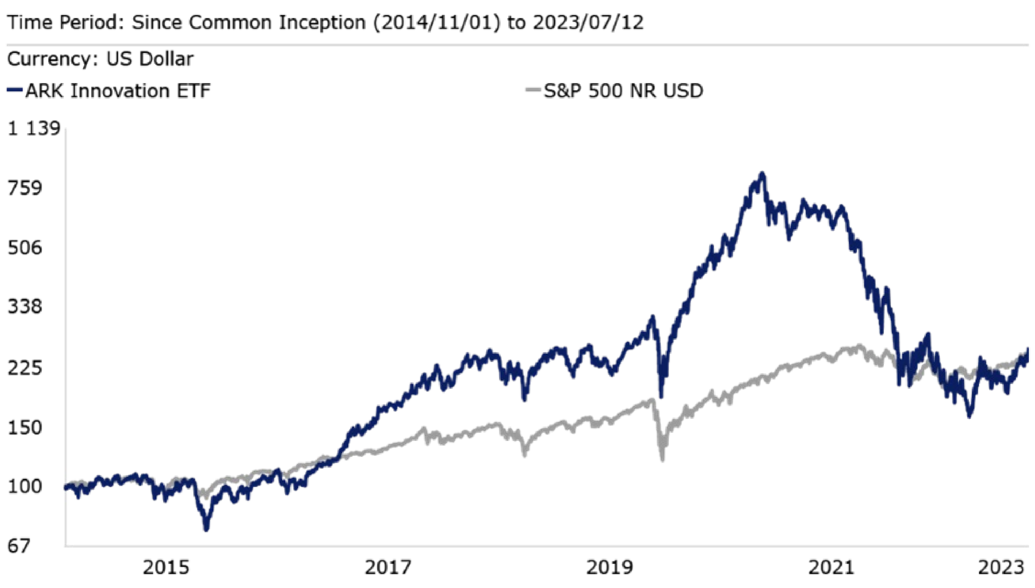
How Long is Long Term?

Several fund managers use the ARK Innovation ETF investment growth chart to show how NOT to invest. The rise and fall in the performance profile does look dramatic.



Despite this seemingly dramatic performance, criticising the manager, Cathie Wood, is not a useful approach, as the performance profile is not the problem. Rather, one should assess equity funds on short-term performance, as this - whether good or bad - is.

Let's dive in and assess the appropriate evaluation periods for equity funds. We will use S&P 500* daily returns over a 96-year period for the analysis.

Short-Term

The table below summarises S&P 500 returns over the analysis period. As an example, 31% of all rolling 1-year returns (*i.e., each day's return represents the annual return for the prior 365 days)* are negative. The lowest return was -71% which is significant, and so is the highest of 171%. Given the volatility and wide range of outcomes, short-term periods are inappropriate for evaluating equity funds.

Rolling Period	Return		
	% Negative	Lowest	Highest
1 day	33%	-20%	17%
1 week	44%	-28%	26%
1 month	40%	-42%	67%
1 year	31%	-71%	171%
3 years	22%	-46%	38%

Medium-to-Long-Term

As the rolling periods increase, the results improve. As shown in the table below, the proportion of negative returns decrease and the range of returns is tighter (i.e., a lot more predictable). The lowest historic returns are better than those over shorter rolling periods. However, even up to 10 years, the S&P 500 delivered negative returns which means a reasonable probability of such still exists.

Rolling Period	Return		
	% Negative	Lowest	Highest
5 years	20%	-23%	30%
10 years	12%	-10%	17%
20 years	4%	-4%	15%
30 years	0%	3%	16%

Even up to 20 or 30 years, the range between the lowest and highest return attained is still large. It takes a bit of luck to have been born at the right time and invested at the right time to be on the upper end. It is comforting though that on average, returns over the long periods are good as shown in the 20-year chart.

The data shows that what you see in the short run is not necessarily indicative of what happens over the long-term. Cycles are prevalent, but start to smooth out over time. Prospects improve the longer the period.

This suggests that when thinking about long-term investing, investors should probably be thinking more about lifetime investments as opposed to discrete periods. The longer the period, the better, as long you are invested in the right product.

Back to ARK

Therefore, rather than using the most recent performance as a gauge of long-term prospects, it is more useful to focus on the investment philosophy and process followed. The team at ARK carries out some great research, so the key question is whether this can be used to build portfolios that deliver on client objectives over time. This question takes time to answer, and is not immediately apparent in short-to-medium term numbers. One requires the kind of qualitative work we do at Seed to help improve the odds of picking out the long-term winners.

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For guidance and assistance, please reach out to our Investment Team on investmentteam@seedinvestments.co.za.

Chart Source/s: Morningstar Direct (11 July 2023). Return in USD from 04/01/1928 to 11/07/2023.

**The S&P 500 commenced on 4 March 1957. Prior history commenced in 1923 when the Standards Statistics Company created its first stock market index comprising 233 companies computed weekly. Three years later it developed a 90-stock composite price index computed daily. This expanded over the years.*
All data is sourced from Morningstar Direct