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Is volatility and low growth the new normal?

Investment is a long term undertaking, and even though we caution against paying attention to short term media noise, it's hard for investors to ignore the headlines. On a subjective basis at the moment it can feel that for every step we take forward, our portfolio falls back two steps. And when stock market commentators tell us that 'this is the new norm,' we may begin to question why we even bother to invest in global equities.

In response to this, investors may like to consider the following. First of all, the volatility we're experiencing may well be 'the new norm' – but only in the short term. Most stock market commentators operate according to very short time horizons, of say 6 to 12 months. The time horizon of a typical investor, on the other hand, is more likely to be 6 to 12 years. So yes, volatility is probably here to stay until a number of major economic issues have been resolved, most notably European sovereign debt. But far from being a permanent fixture it is, in a sense, part of the normal pattern of long term investing.

To illustrate, the following table, from January 1972 to June 2011, a nearly 40 year period, shows the proportion of the time that investors' portfolios were rising or falling, looking at monthly, quarterly, half yearly and annual reporting cycles. The figures are based on a portfolio comprising 70% shares.

Behaviour of 70% stocks portfolios

Portfolio is...	% of months	% of quarters	% of half years	% of years
Falling	33	28	23	18
Recovering	41	31	24	19
Rising	26	41	53	63

(Source: www.riskprofiling.com)

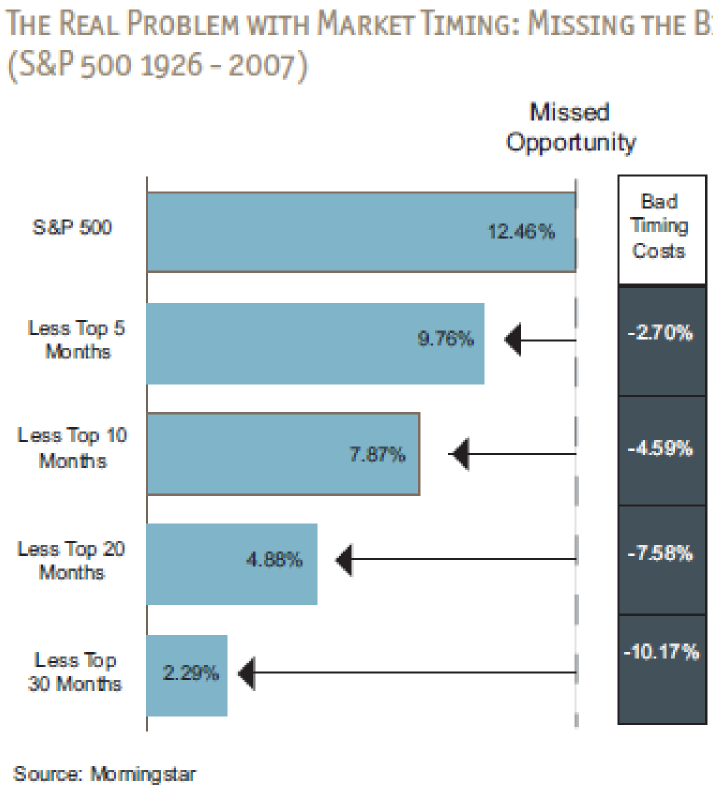
What the figures show is that if we look at portfolio performance on a monthly basis, for almost three quarters of the months (74%) portfolios are either falling (33%) or in recovery mode (41%). Our subjective investment experience, according to this most frequent reporting cycle, is therefore mostly negative or neutral. Only 26% of the time will we see the value of our portfolios increase.

But when we look at our investment journey on a quarterly basis, things appear a little less gloomy – 59% of the time portfolios are falling or recovering, but 41% of quarters they rise.

If we step back still further and review our portfolio only on an annual basis, our subjective investment experience becomes positive 63% of the time, with markets falling or recovering the remaining 47%. And interestingly, those portfolios with less exposure to equities are likelier to deliver even more positive subjective investment experiences when reviewed on an annual basis.

What conclusions can we draw from this analysis? First and foremost, far from it being unusual for one's portfolio to be falling or in recovery mode, this is a perfectly normal occurrence when we look at global stock market investing from a long term perspective. In only 26% of months for the past 40 years have portfolios increased. That is the norm.

Secondly, and perhaps self evidently, despite growth occurring in a minority of months, when it does occur it more than makes up for periods of decline or recovery. The following table, showing stock market performance between 1926 and 2007 shows how much annual returns were affected by missing only a few months in that 80 year time period.



Even though markets may move upwards for a minority of the time, when they do, their performance compensates for the majority of time that they don't seem to be going anywhere.

Thirdly, the less often you look at your portfolio, chances are the happier you will be by what you see. Although it's human nature to want to check what impact the latest crisis is having on our portfolio, this behaviour doesn't serve us well. A calm, informed, long term perspective provides the best support for our investment journey.

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