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Patience is a Virtue

by Stephen Nguyen, CFA

Patience is essential to daily life and even more so if you are parents to young kids. When I was a child, I was often told to "be patient", which meant staying calm in the face of delay, frustration or adversity. We all have many opportunities in life to practice this virtue; being stuck in traffic, the ups and down of parenthood, or indeed, managing one's investments. By understanding the importance of having patience, we can maintain our focus on our long-term goals, and not let short term noise push us into taking unnecessary action. Time in the market is better than timing the market, as they say, as it allows investors to benefit from the power of compounding, which Albert Einstein once referred to as the 8th wonder of the world[1].

An investment portfolio needs to have a clearly defined goal and be built with relevant constraints in mind. One other aspect which is often overlooked is determining the appropriate time horizon, which we think of as the minimum timeframe investors should commit to in order to reduce their risk of experiencing a negative outcome.

There is no magic number on how long one should stay invested. All else being equal, the longer you stay invested the better your chances of achieving your goals. However, we acknowledge it is not always practical for investors to stay invested for 10 or 20 years, so instead we communicate a minimum recommended timeframe for each of our portfolios.

In determining the recommended minimum investment horizon for our funds, we balance considerations around both the funds' objectives and risk profile. Lower risk portfolios should not be as sensitive to market movements and typically would suit investors with a shorter timeframe, while a portfolio with a higher allocation to risk assets and a higher target return are more prone to short term drawdowns and hence require a longer investment horizon.

So how do we arrive at the minimum recommended horizon for our funds? We start at the core of the investment process, namely the strategic asset allocation (SAA). The SAA represents our optimised long-term asset class weightings which are constructed to deliver the highest probability of achieving the target outcome while balancing that against drawdown risks. This increases the chance of delivering a smoother journey for investors.

We analyse data from these SAAs over many years and study the range of returns over various timeframes along with the expected return to arrive at an appropriate minimum investment horizon. In our analysis, we observe that over shorter time periods of 1 to 3 years, the range of outcomes is very wide. Investors are more likely to experience a negative outcome should they not stay invested for at least the minimum recommended holding period. Particularly in any given 12-month period, the likelihood of a negative outcome is high given the inherent volatility of markets and the magnitude, can at times, be severe.

However, as the recommended holding period increases, the range of returns becomes narrower, and the probability of experiencing a negative outcome is greatly reduced after holding for around 5+ years for most risk balanced portfolios. The range of outcomes is at its narrowest from around 7 years onwards, meaning the likelihood of a negative outcome is further reduced and the variability around the objectives is minimised.

Being patient in the face of adversity is key to a happy life, and a healthy investment portfolio. The reality for investors is that extending your investment horizon will help you to achieve your financial goals. Good things truly do come to those who wait.

Source: [1]High Returns from Low Risk – a remarkable stock market paradox. Pim Van Vliet and Jan De Koning

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Important notes

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