

INSIGHT

THE GREATEST WEALTH IS **YOUR PEACE OF MIND...**



BARNETT
RAVENSCROFT
WEALTH MANAGEMENT

Live by performance, die by performance



Live by performance, die by performance

On any piece of investment literature the warning ‘Past performance is not a guide to future performance’ is always prominent, in bold, and generally glossed over by most readers. Yet all actively managed funds are sold specifically on their ‘great’ past performance, usually by comparison to a ranking against their peers or a market benchmark. Those that perform poorly never get to see the light of day in adverts or best-buy lists. Many investors would be well advised to take heed of this warning. Those investing in a systematic way, seeking to capture market returns for market risks taken on, certainly do.

Deep down in the investor psyche lurks a little demon that wants to get rich quick, suffers terrible pangs of FOMO (fear of missing out) and becomes blinded by the urge to jump on the runaway train of rampant performance despite the warning signs that flash as they clatter down the track ‘Past performance is not a guide to future performance...past performance is not a guide to future performance’.

We know too, from experience, that often funds that outperform over the shorter-term are riding an investment style train, such as technology companies or growth stocks, that happens to be in favour. Markets make managers. Combined with the recency bias gremlin that also lurks in our psyche, which places more weight on more recent experiences than on those that occurred further in the past, and exacerbated by the fact that most investors get excited and invest only after much of the stellar performance has been delivered, one can spot the coming train wreck. The harsh reality is that past performance does not tend to persist. This is clearly demonstrated in the chart below which shows that top performing managers (green) in one period - defined as top quartile (top 25%) in a rank of their peers - end up scattered randomly, as expected by chance, throughout the ranking over the subsequent period.

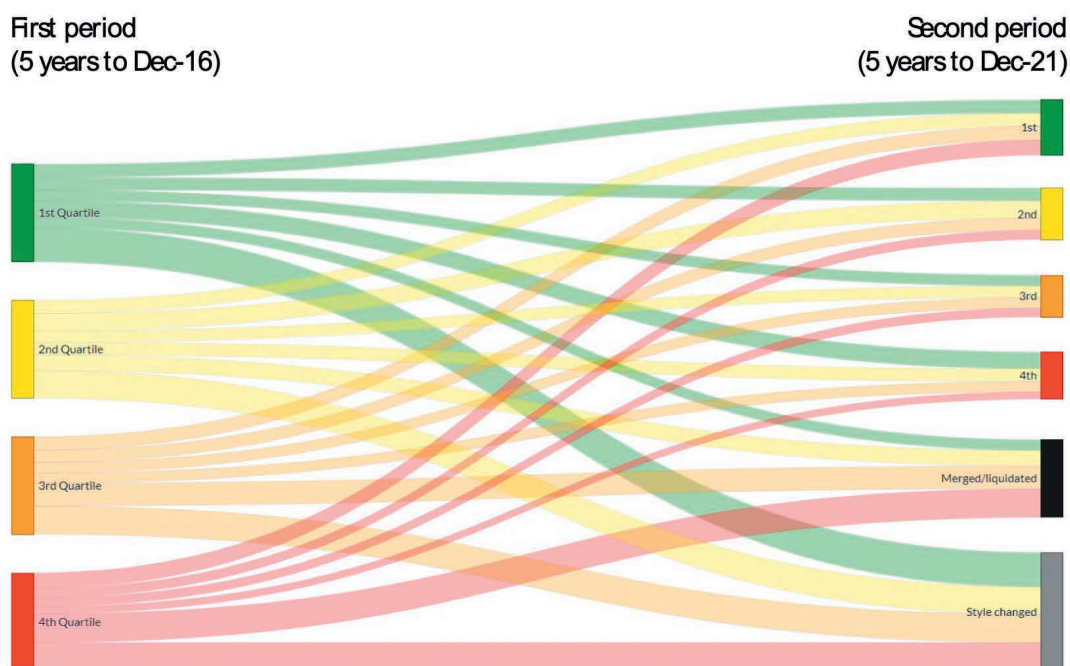


Figure 1: Past performance is not a guide to future performance

Source: Albion. Data: US Persistence Scorecard Year-end 2021 © All rights reserved. www.spglobal.com

Taking a look at one of the funds that hit the headlines in 2020-1 with its stellar performance provides a sobering insight into the dangers of chasing performance. ARK Innovation – a highly concentrated, high risk, ‘disruptive innovation’ technology fund - had a stellar rise of over 214% from the start of 2020, in US dollar terms, to its peak on 12th February 2021. Its CEO Cathy Woods was a regular on US business TV shows, spawning an almost cult-like following. It hit a unit price high of \$157 (up from US\$50 on 1st Jan 2020), but has since then plummeted to US\$37, losing 76% of its value (to 12th May 2022). Its return is now almost exactly in line with the broad US equity market for those invested over the entire period. If you live by performance, you die by performance. It is worth remembering that the worst fall in the UK equity market since 1900 was of a comparable magnitude (-73%) in 1973-4.

Unfortunately, performance chasing investors tend to come to the game late, as the chart below clearly shows. Net flows into the ARK fund peaked at the start of 2021, just as performance peaked. Assets gathered from investors in 2020 and 2021 represented around 90% of all net inflows since the fund’s inception in 2015¹. That is not good news.

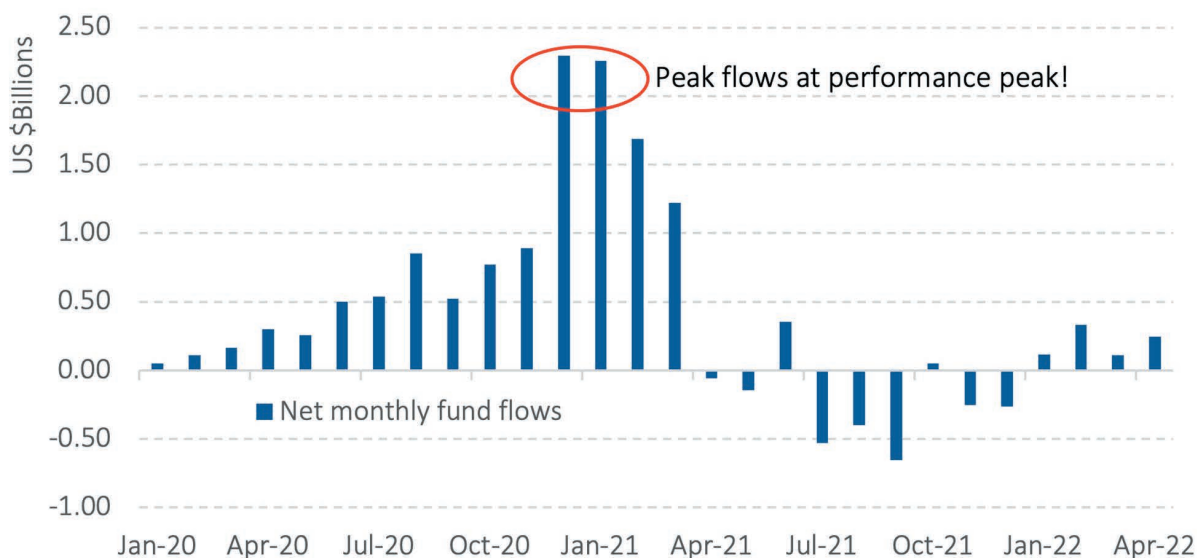


Figure 2: Bad timing decisions punish late arrivals – ARK fund (ARKK) net monthly flows

Source: ARKK net fund flows from Morningstar Direct © All rights reserved 2022.

It is evident that most investors failed to capture the strong upswing, piling in at the top and suffering the subsequent calamitous downturn. The average investor’s return is likely to be materially worse than the fund’s return, on account of this poor timing, although no exact data are yet available.

Investing is a hard enough emotional challenge at the best of times. Chasing performance just adds to the complexity and stress involved and may well put long-term investment goals at risk. Taking specific risk on such a fund is simply a gamble.

Next time you read a product factsheet or see an advert for a fund in the paper avoid the siren calls of stellar performance and take a moment to reflect on the free, sensible, and seemingly boring advice it is obliged to provide: ***‘Past performance is not a guide to future performance’***.

End notes

1. Morningstar (2021) ARKK: An Object Lesson in How Not To Invest. Amy C. Arnott. <https://www.morningstar.com/articles/1071658/arkk-an-object-lesson-in-how-not-to-invest> Accessed: 11-05-2022

Other notes and risk warnings

Use of Morningstar Direct® data

© Morningstar 2022. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied, adapted or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information, except where such damages or losses cannot be limited or excluded by law in your jurisdiction. Past financial performance is no guarantee of future results.

Risk warnings

This article is distributed for educational purposes only and must not be considered to be investment advice or an offer of any security for sale. The reference to any products is made only to make educational points and must, in no circumstances, be deemed to be any form of product recommendation.

This article contains the opinions of the author but not necessarily the Firm and does not represent a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable but is not guaranteed.

Past performance is not indicative of future results and no representation is made that the stated results will be replicated.

Errors and omissions excepted.

Barnett Ravenscroft Wealth Management is a trading name of Barnett Ravenscroft Financial Services Ltd which is authorised and regulated in the United Kingdom by the Financial Conduct Authority FRN: 225634 and registered in England and Wales under Company No. 04013532.

The registered office address of the Firm is 13 Portland Road, Edgbaston, Birmingham, B16 9HN

INSIGHT

**Live by performance,
die by performance**



**BARNETT
RAVENSCROFT**
WEALTH MANAGEMENT

Barnett Ravenscroft Wealth Management
13 Portland Road
Edgbaston
Birmingham
B16 9HN
UK

Tel: +44 (0)121 454 0910
Fax: +44 (0)121 410 5619
Email: info@brwm.co.uk
Web: www.brwm.co.uk