INSIGHT

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

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WEALTH MANAGEMENT

Setting sensible expectations for investment returns

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> *Man has the hardest job of all, the job of making decisions on incomplete data.*
>
> Henry Kuttner

When market returns are kind, as they have been in recent times, it can be too easy to forget that bad times in investing will come along at some stage, leading to large and/or protracted falls in value. We hope markets are kind, but without a crystal ball no investor possesses any ability to accurately forecast the 'whats, whens and hows' of such downturns.

As your adviser, part of our role is to stress test your financial plan – using what we understand about markets - to ensure that your ability to achieve your financial goals is built on reasonable expectations. We recognise that markets give and take.

One important element of planning for the future is building a reasonable understanding of what a portfolio of investments can deliver. We follow a logical framework to achieve this, illustrated in the graphic below. Following such a framework helps us form central case expectations of future returns. The words 'central case' are important here – these assumptions sit at the centre of a wide distribution of possible outcomes.

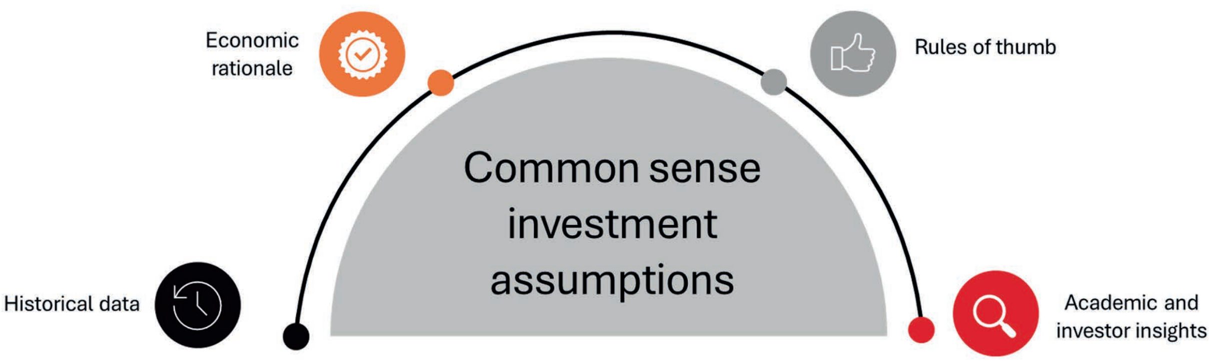

Figure 1: A logical framework for setting sensible expectations for investment returns
Source: Albion Strategic Consulting

To illustrate the point that returns from stock and bond markets are not expected to come in straight lines, consider the figure on the following page. We take the average calendar year return of global stock markets[1] from the past 30 years (1994 to 2023) – which was an impressive 9.4%, before inflation – and the volatility (a measure of how bumpy the ride was) over the same period of 18%. The figure shows one hundred 10-year simulations with the same average return and same volatility as inputs – perhaps the futures of one hundred alternative universes!

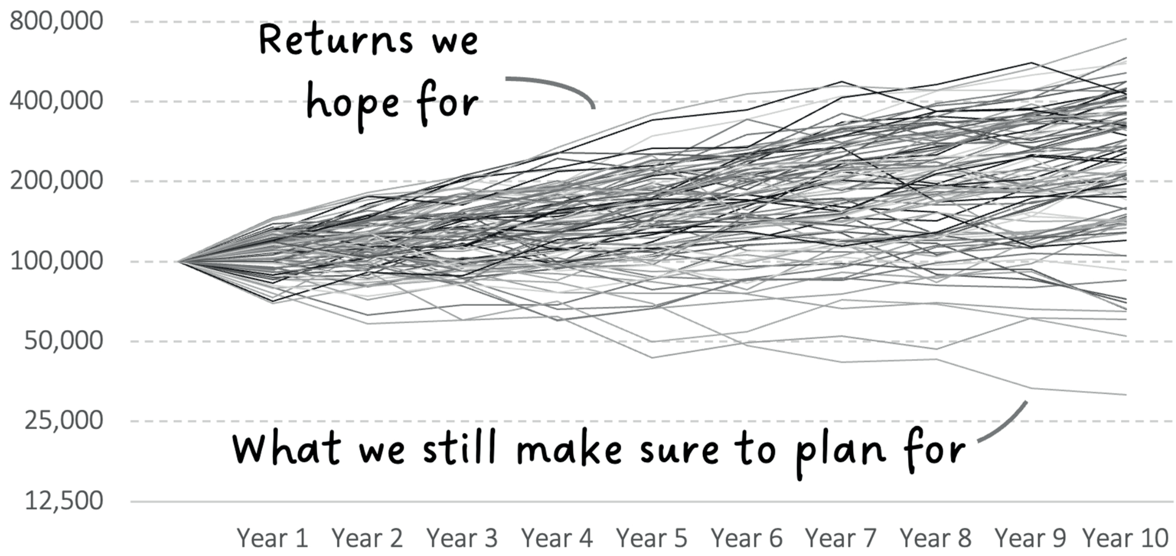

Figure 2: One hundred 10-year return simulations, growth of 100,000

Source: Albion Strategic Consulting. One hundred 10-year Monte Carlo simulations using arithmetic average return of Albion World Stock Market Index (https://smartersuccess.net/indices) from 1994-2023 (9.4%) and standard deviation of annual returns (18%), priced in USD in nominal terms.

Ultimately, an investor won't know which one of an infinite number of possible paths they are on until after the fact. This is why it is important to make sensible expectations about the future returns markets could deliver, and crucially meet with your adviser on a periodic basis to see which path markets could be taking.

During tough times, this might mean curtailing spending or saving more – part of the role of your financial planner is to advise if and when this might be necessary. The longer one remains invested, the greater the opportunity for shorter term noise to subside and longer term expected outcomes to prevail. A financial plan built on sensible assumptions and maintained through time gives investors the best chance of achieving their financial goals.

End notes.

1.
Data: Albion World Stock Market Index, https://smartersuccess.net/indices

Other notes and risk warnings

Use of Morningstar Direct© data

Risk warnings

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