Momentum Investments

Short-term investment outcomes – What to expect

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Short-term investment returns can often be different to what is expected, but Momentum Investments is here to guide investors in understanding the short-term outcomes and making sense of the risks involved. Often incorrect conclusions are made and, as a result, irrational investment decisions are actioned based on short-term returns. Researching and analysing investments and historical returns for a one-year period do not provide any reliable insight into a particular portfolio's prospects for performing well and delivering on certain predefined future investor outcomes. The reason is that one-year periods do not reveal enough about a portfolio's ability to guide it through a full market cycle, which includes bull and bear markets.

Outcome-based solutions are constructed to deliver on investor goals with the highest possible likelihood, over the predefined investment horizon, while managing the risk of changing investment values at the same time. To be able to deliver on certain objectives, it is important to note that a fair amount of fluctuation in the value of the investment will be evident and required in the short term. Put simply, investors will experience the market's ups and downs in the short term, but how much short-term risk should investors expect on their journey towards delivering on their goals?

For longer-term investments, it often makes sense to have higher exposure to growth asset classes, which include local and global equity and property. These growth asset classes tend to deliver higher expected returns in the long term, but also come with higher risk and, therefore, higher expected changes in investment values in the short term. It is often necessary to accept more risk in the short term to deliver higher returns in the longer term and, therefore, deliver on the more difficult-to-achieve investor goals.

Looking at what Momentum Investments expects from different risk-profile portfolios on average in the short term (one-year periods), the chart and table below suggest that the more exposure to more risky growth asset classes (Risk-profile Portfolio 5 (CPI+6%) and Risk-profile Portfolio 4 (CPI+5%)), the higher the short-term negative returns could be. There are, however, two aspects to note:

- The average negative return for a one-year period for a multi-asset class and multi-strategy portfolio is much less than pure equity and the resultant maximum drawdown almost halves for a Risk-profile Portfolio 5 (CPI+6%) solution relative to equity (negative 37% compared to negative 21.6%), even though the expected period percentage of negative returns are similar.
- The solutions with a higher focus on short-term capital preservation (Risk-profile Portfolio 1 (CPI+2%) and Risk-profile Portfolio 2 (CPI+3%)), do have less exposure to risky asset classes and, therefore, the average expected negative returns are minimal, but also the average expected positive returns are significantly lower than pure equity.

Chart 1: Average one-year return measured from January 2006 to January 2019

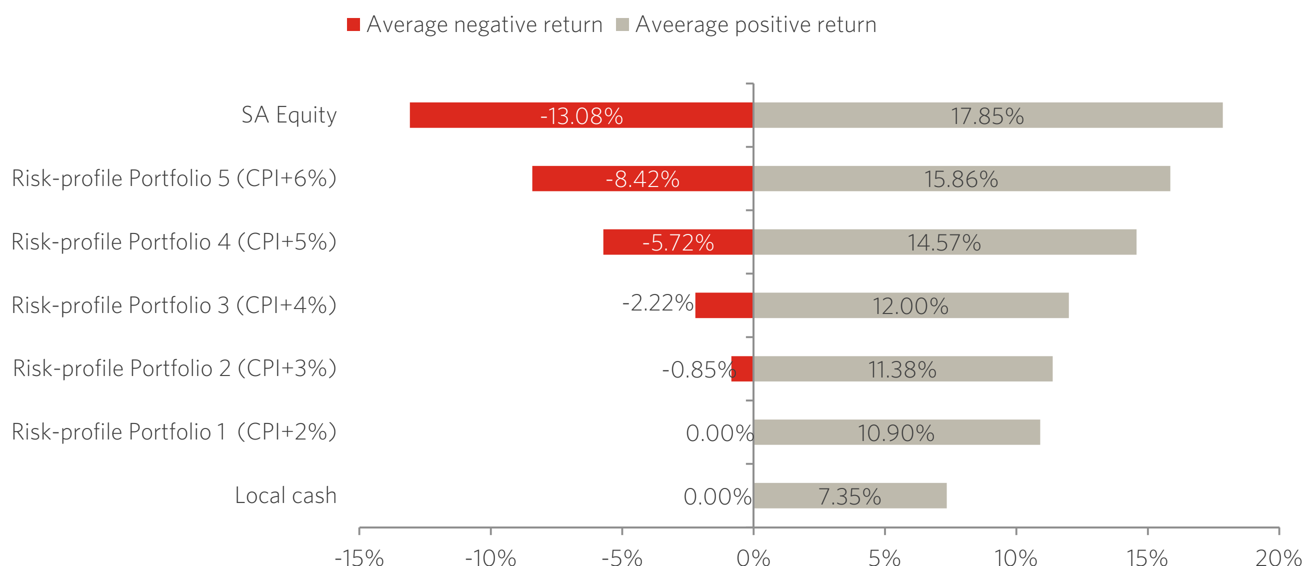


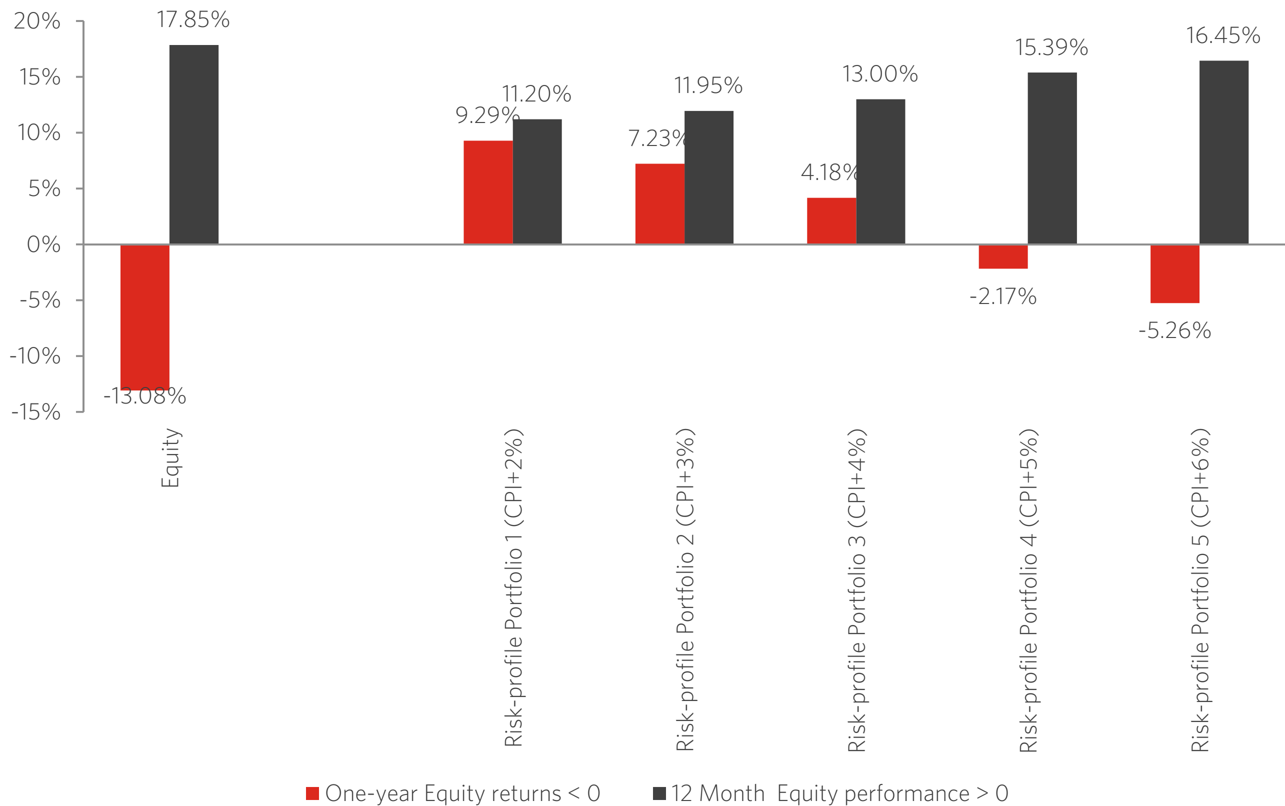
Table 1: Risk calculations measured from January 2006 to January 2019

	Percentage positive periods	Percentage negative periods	Maximum drawdown
Local equity	88.4%	11.6%	-37.0%
Risk-profile Portfolio 5 (CPI+6%)	88.4%	11.6%	-21.6%
Risk-profile Portfolio 4 (CPI+5%)	90.4%	9.6%	-14.4%
Risk-profile Portfolio 3 (CPI+4%)	97.3%	2.7%	-6.6%
Risk-profile Portfolio 2 (CPI+3%)	98.6%	1.4%	-4.9%
Risk-profile Portfolio 1 (CPI+2%)	100.0%	0.0%	-3.4%
Local cash	84.2%	15.8%	0.0%

As mentioned, chart and table 1 represent the average return from the different risk-profile portfolios, equity and cash in periods when they delivered negative returns compared to periods when they delivered positive returns for a one-year period. It is important to observe the returns of the portfolios in instances when the equity market delivers negative and positive outcomes. From this observation, there is an indication of how correlated the solutions are to the equity market itself.

The chart below shows the same relationship. It shows the average return outcomes of the different risk-profile portfolios during periods of positive and negative equity market returns. Using Risk-profile Portfolio 3 (CPI+4%) as an example, when the equity market delivered a negative return for any one-year period, measured from 2006 to 2019, the average return was negative 13.08%. The average return during those same one-year periods for Risk-profile Portfolio 3 (CPI+4%) was 4.18%.

Chart 2: Measured from January 2006 to January 2019



What is evident from chart 2, is the risk-profiled portfolios are quite defensive and, therefore, do protect capital to a large degree, even in instances when the equity market has delivered negative returns.

On the flipside, it is also comforting to know that the more aggressive portfolios largely keep up with equity market returns when the equity market offers positive outcomes.

The deliberate focus on risk management in portfolio construction for the outcome-based solutions is key in delivering on client goals in the most robust manner. Diversification and risk management are the fundamental building blocks of portfolio construction and management of the journey towards the goal. Different goals and investment horizons warrant different investment constructs and solutions. The resultant effect is the short-term risk of these solutions can and will be very different. Compared to pure equity, the constructed solutions should deliver more robust outcomes in the short term.

Instead of only focusing on either risk or return, it is important to note there is a positive relationship between risk and reward. The focus should, therefore, remain on achieving the objective within the predefined risk parameters through a suitable robust outcome-based investment portfolio.

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