



## Is Time in the Market More Important Than Timing the Market?

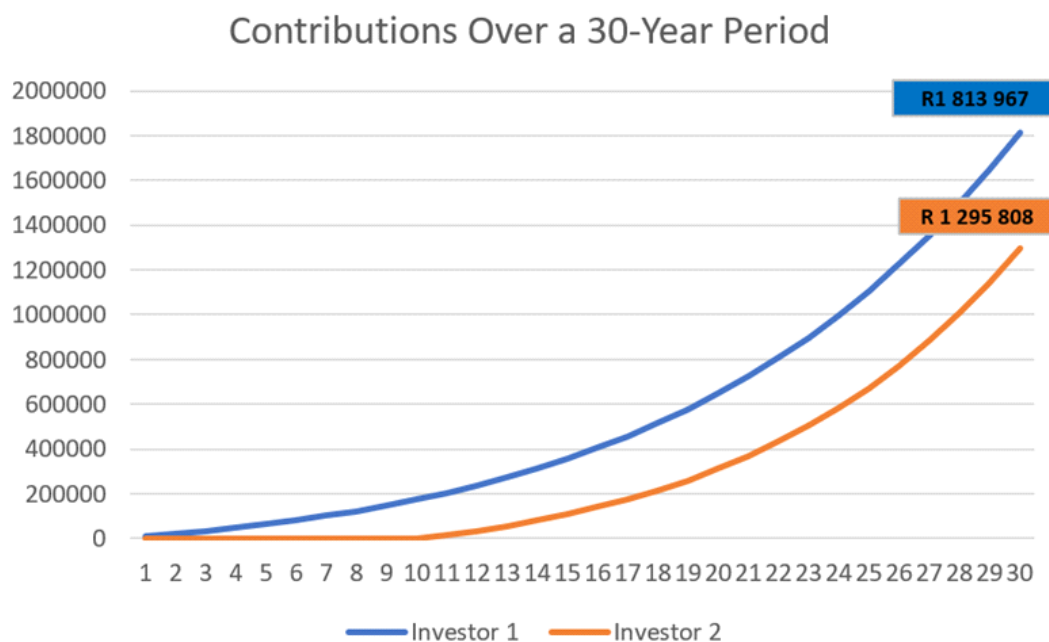
People in general tend to think linearly; for example, we overestimate what we can achieve in one year and underestimate what we can achieve in ten years. The same is true for our investments, we assume that starting to save later in life won't make that much of a difference or that we can make up for our lack of savings with good returns. To test these assumptions, we set out to answer two questions, does performance chasing work, and can higher returns compensate for starting to save later in life?

To find out whether performance chasing really works, we analysed the high equity funds available over the last 10 years to see how the funds' performance varied. On average if a fund was in the 1<sup>st</sup> quartile in one year (i.e., in the best performing 25% of funds) there is a 34.64% chance that it will stay in the 1<sup>st</sup> quartile in the following year. It should also be noted that there is a 21.57% chance that it will be in the 4<sup>th</sup> quartile (i.e., the worst performing 25% of funds) in the following year. Similarly, there is a 30.72% chance that a fourth quartile fund will remain in the 4<sup>th</sup> quartile and a 41.83% chance that it will be in the 1<sup>st</sup> or 2<sup>nd</sup> quartile (i.e., in the best performing 50% of funds) in the following year. Of all the funds analysed, no fund was constantly in the 1<sup>st</sup> quartile nor constantly in the 4<sup>th</sup> quartile. This shows that there is no guarantee that past performance will continue into the future. Interestingly, the best performing fund over the 10-year period was only in the 1<sup>st</sup> quartile 60% of the time and was in the 4<sup>th</sup> quartile for 30% of the time.

When it comes to accumulating wealth there are two main components to consider namely, the returns you achieve and how much you are saving. From the above statistics it is clear that there is very little chance of consistently selecting the best performing fund, so the only component you are able to control is your saving. Is starting to save earlier enough to compensate for poor returns?

In order to answer this question, we created a hypothetical investment scenario spanning 30 years, where two investors start contributing at different times.

Investor 1 (blue line) earned a 4<sup>th</sup> quartile return of 7.65% for his entire investment period. He contributed R10 000 each year, adjusted for inflation, for the full 30-year period. Investor 2 (orange line) earned a 1<sup>st</sup> quartile return of 9.76% for his entire investment period but made no contributions for the first 10 years and then contributed R10 000 per year, adjusted for inflation, for the last 20 years. The results are illustrated in the graph below.



By the end of the 30-year period Investor 1 would have accumulated R1 813 967 while Investor 2 would only have accumulated R1 295 808, despite earning 1<sup>st</sup> quartile returns. In order for Investor 2 to accumulate the same wealth as Investor 1, he would have to earn a return of 13.04%. This return is nearly double that of the 7.65% earned by Investor 1. Another way for Investor 2 to accumulate the same wealth as Investor 1 would be to increase his contributions. Investor 2 would have to contribute R14 000 per year, adjusted for inflation, for the last 20 years of the investment period, as opposed to the R10 000, adjusted for inflation, that Investor 1 contributes during the 30-year period. These figures clearly illustrate that the positive effect of compounded returns achieved by starting to save earlier is critically important for wealth creation.

Fund performance is unpredictable; however, this can be overcome by ensuring that you start saving as early as possible. This means that the role of the financial adviser in encouraging investors to start saving early is vital in maximising the investor's overall wealth. Time in the market is definitely more important than timing the market.