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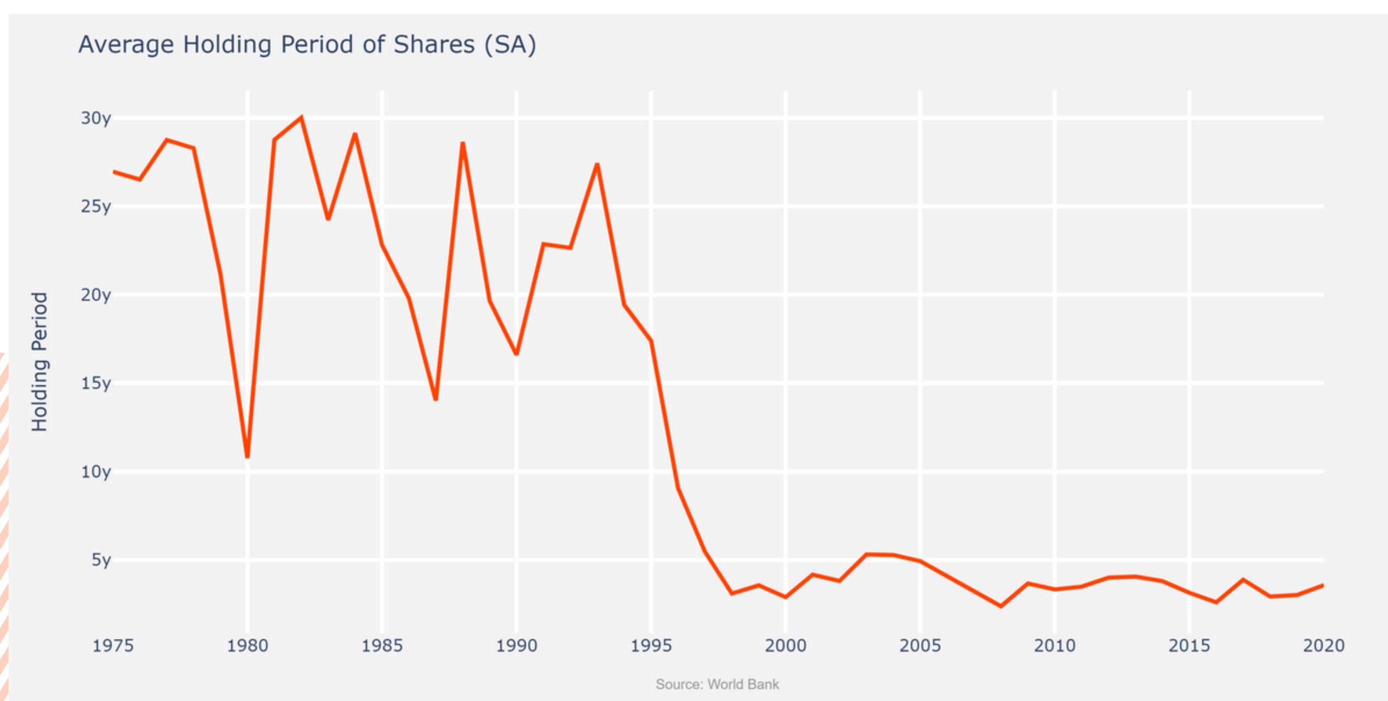
The Holding Period Decline

by Garrett Nel

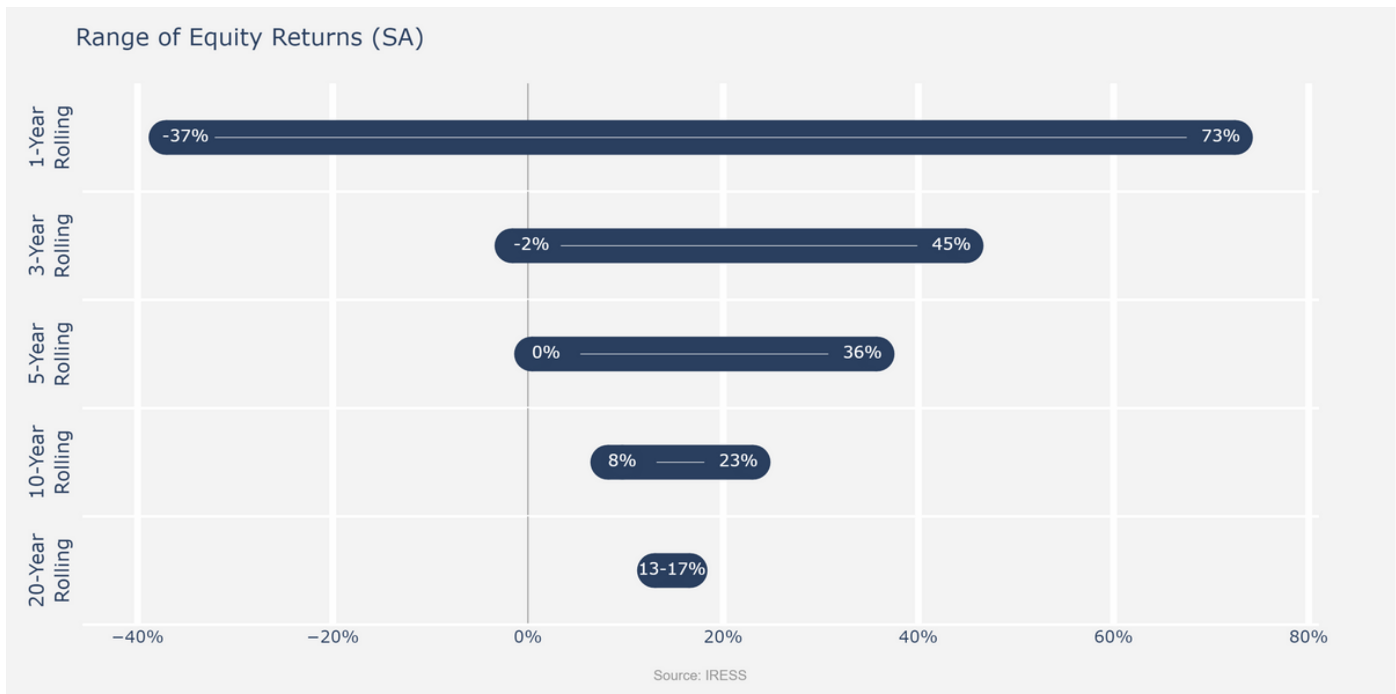
Investors are frequently told and are familiar with the idea that investments should be made with a long-term outlook. What this means, is that the desire to take on short-term risks for small potential gains should be resisted in favour of keeping to one's formal long-term strategy. A disciplined investor would remain focussed on the long-term goal regardless of the impulse to sell out when markets become volatile, or alternatively the desire to make a trade on a stock that the investor has a good "feeling" about without much further consideration.

Since no investor is perfectly rational, not following the common wisdom of staying in the market may be the vice of many market participants. This idea is supported by considering the average holding period of equity shares on the JSE, as depicted in the graph below. Although very volatile, it is clear to see that the average holding period of shares has declined since the year 1975. For the period between 1975 and 1995, the average holding period of a share was 23 years, while the average declined after 1995 to only 3.7 years.



There is a reasonable explanation for the rapid decline in holding period observed around 1995: during this time, the JSE transitioned from an open outcry system to an electronic trading network. The ease of access, in conjunction with the reduction in costs associated with trading lead to an inevitable increase in market activity. Although this improvement in the JSE should be for the benefit of investors, it is possible that the shift also inadvertently did some harm to the consistency of the average investment outcome.

The annualised rolling returns for an investment in the FTSE/JSE All Share Index for various holding periods are shown in the figure below. It is clear to see the benefit in risk reduction that one may enjoy simply by remaining invested in the market for longer. Since 1995, the range of the average return for a holding period of around 3 years is between -2% and +45% per year. At the same time, the range of average holding period returns for a 20-year period is between 13% and 17% per year.



Importantly, it should be noted that although one may be tempted by the potential of a yearly 45% return over 3 years, the average return over a rolling 3-year period, versus the average return over a rolling 20-year period, are both 14% per year. What this practically means for investors, is that the reasonable expected yearly return over 3 years and over 20 years is the same, however the longer investment period has significantly lower variation in outcome and is therefore less risky.

Investors should always remember that just because it is now easier than ever to make investments, it does not mean that the strategy should be ever-changing. Short term trades may at times seem appealing, however the evidence still suggests that remaining invested for long periods of time is the only strategy that will stand the test of time.

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