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Fear versus FOMO: a perspective on missing out

Authors: Nel, Head of Multi Asset, Terebinth Capital
Dumisani Ngwenza, Quantitative Analyst and Junior Portfolio Manager, Terebinth Capital

The adage that time in the market beats timing the market generally focuses on the cost to performance of missing the top return days over a specified period. Yet, there is rarely the same focus on what it means for portfolio performance when we manage to avoid the largest down days. In this article, we discuss the trade-off of return for taking on risk or not and how both growth assets and income assets play a role in achieving a return objective while managing risk.

Glacier Financial Solutions (Pty) Ltd, I A member of the Sanlam Group | Private Bag X5 I Tyger Valley 7536 I Email: client.services@glacier.co.za | Tel +27 21 917 9002 I Fax +27 21 947 9210 I Web www.glacier.co.za | Reg No 1999/025360/07 I Licensed Financial Services Provider
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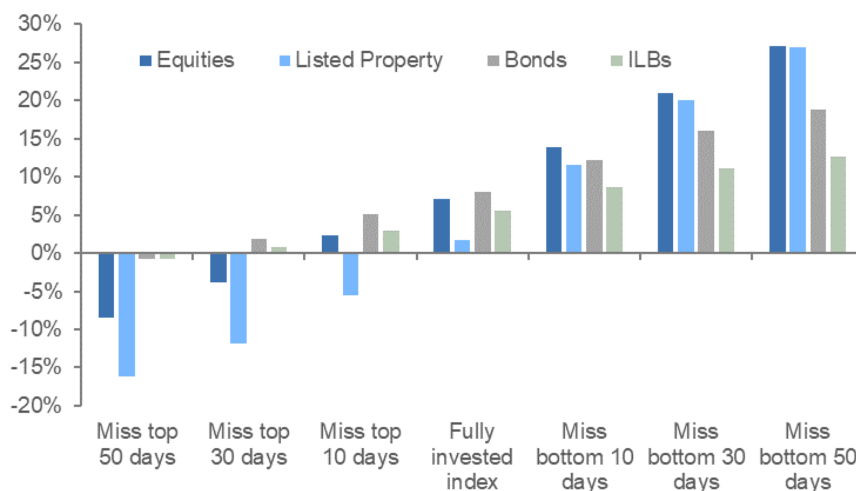
To illustrate the concept of fear – being worried about negative returns on a portfolio – and FOMO – the "fear of missing out" on market rallies (usually referred to as greed), we analyse four major South African listed asset classes over the past 10 years. We are cognisant that our chosen period includes the dramatic market swings during Covid. However, the analysis covering the period prior to Covid paints a similar picture, albeit with fewer extremes given the magnitude of daily shocks during March and April 2020.

Our chosen asset classes are equities (FTSE/JSE Capped SWIX All Share Total Return Index), listed property (FTSE/JSE All Property Total Return Index), bonds (FTSE/JSE ALBI Total Return Index), and ILBs (inflation-linked bonds, FTSE/JSE CILI Total Return Index).

For each asset class, we calculate total return indices where the top or bottom 50, 30, and 10 days are excluded and total return indices where both the top and bottom 50, 30, and 10 days are excluded. The summary results are shown in Figure 1 and Table 1.

Figure 1: Annualised total return when the best/worst days are excluded



The analysis covers the period 31 December 2013 to 31 December 2023

Source: Bloomberg, Terebinth Capital

From the results in Table 1, it is worth highlighting the following regarding returns:

- Excluding the extreme daily performances, whether on the upside or the downside, has a meaningful impact on the annualised return of each asset class.
- Equities and listed property, the more volatile asset classes, have large deviations from the index return on an absolute basis and a relative basis. For example, equities' returns range from -8.5% (when the top 50 days are excluded) to +27.2% (when the bottom 50 days are excluded), which is notably wider than the -0.7% to +18.9% range for bonds. In addition, taking the return as a ratio of the fully invested index performance, equities range from -1.2 to +3.8 compared to bonds' -0.1 to +2.4.
- Missing both the best and the worst performance days enhances returns across the board, but only marginally more so for the more volatile assets (equities and listed property).

The results indicate that removing the extremes reduces the volatility of the various return indices, which makes intuitive sense.

We know that investing is not only about returns but also about the risk we need to take to generate the required returns. As such, we compare the risk-adjusted returns - proxied by the annualised total return divided by the volatility - for the various return series. From the summary results, we infer the following:

- Missing the top days is more punitive for volatile assets (such as equities and listed property) than for less volatile assets (such as bonds and ILBs). This partly reflects the protection given by the yield on bonds and ILBs.
- Missing both the best and worst days results in a better reward-to-risk ratio than the fully invested index thanks to a slightly higher return but meaningfully lower volatility.

Table 1: Summary results of excluding the best/worst days

		Miss top:			Miss bottom:			Miss top and bottom:		
Asset class	**Index**	**50 days**	**30 days**	**10 days**	**50 days**	**30 days**	**10 days**	**50 days**	**30 days**	**10 days**
	Annualised total return									
Equities	7.1%	-8.5%	-3.8%	2.3%	27.2%	21.0%	13.9%	8.6%	8.6%	8.8%
Listed Property	1.7%	-16.2%	-11.9%	-5.5%	27.0%	20.1%	11.6%	4.6%	4.1%	3.6%
Bonds	8.0%	-0.7%	1.8%	5.0%	18.9%	16.0%	12.2%	9.3%	9.4%	9.1%
ILBs	5.6%	-0.7%	0.8%	2.9%	12.7%	11.1%	8.6%	6.0%	6.0%	5.8%
	Volatility									
Equities	17.4%	15.7%	16.1%	16.7%	15.2%	15.6%	16.2%	13.3%	14.2%	15.5%
Listed Property	19.9%	17.1%	17.5%	18.3%	16.0%	16.5%	17.3%	12.5%	13.6%	15.4%
Bonds	9.0%	8.1%	8.3%	8.5%	7.5%	7.7%	8.1%	6.4%	6.8%	7.6%
ILBs	6.2%	4.4%	4.6%	4.8%	5.1%	5.2%	5.5%	2.8%	3.2%	3.8%
	Risk-adjusted return (Total return/Volatility)									
Equities	0.41	-0.54	-0.24	0.14	1.79	1.34	0.86	0.65	0.60	0.57
Listed Property	0.09	-0.95	-0.68	-0.30	1.69	1.22	0.67	0.37	0.30	0.24
Bonds	0.88	-0.08	0.22	0.59	2.51	2.07	1.51	1.47	1.37	1.21
ILBs	0.91	-0.15	0.18	0.61	2.50	2.13	1.57	2.15	1.91	1.52

The analysis covers the period 31 December 2013 to 31 December 2023

Source: Bloomberg, Terebinth Capital

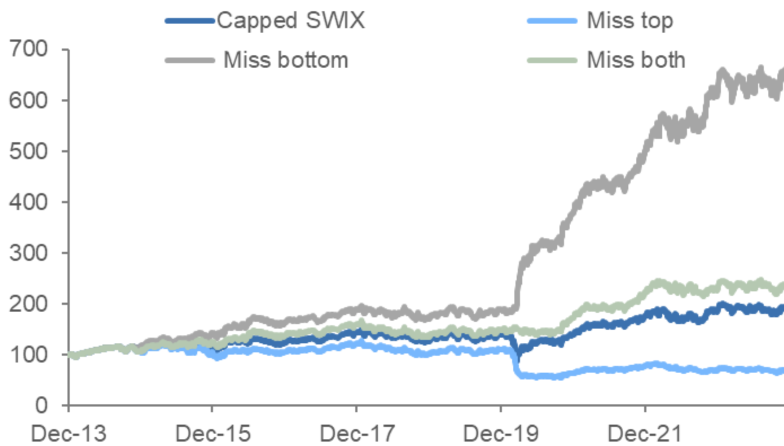
Prudence pays

To represent the analysis in a more intuitive way, Figure 3 shows the cumulative total return of the fully invested for the Capped SWIX, alongside that of the indices where we miss the best 30 days, the worst 30 days, and both over the 10 years to December 2023.

The significant underperformance when missing the top days illustrates the risk of attempting to time the market but doing so unsuccessfully. The portfolio will take many years to recover and meet the fully invested index. Assuming the fully invested index continues to grow by 7.1% a year, as per Table 1, and the “miss top” index by double that rate, it would take almost 17 years to make up the shortfall – time many investors do not have.

Missing the bottom days highlights that managing downside risk is as rewarding, if not more, than identifying periods of top returns in advance, based on the substantial outperformance. Admittedly, the analysis assumes perfect foresight in financial markets – a superpower we wish we had.

Figure 2: Capped SWIX cumulative performance when missing the best/worst 30 days



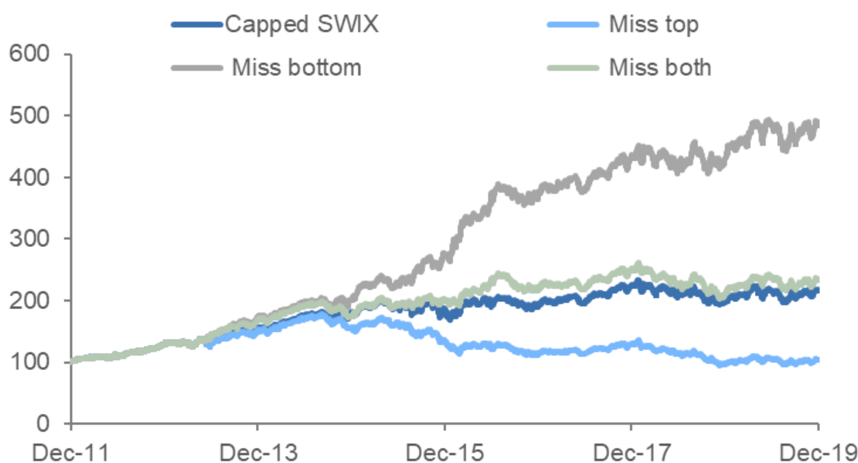
The analysis covers the period 31 December 2013 to 31 December 2023

Source: Bloomberg, Terebinth Capital

Missing both the top and the bottom days suggests we can outperform the fully invested index –on an outright and a risk-adjusted basis – if we avoid the extremes in both directions. These volatile market periods usually occur when significant declines are followed by substantial market rebounds, generally at the market trough and thus when fear is rife and sentiment sour. The caveat is that this clustering of large down days followed by large up days is not guaranteed, with the Nikkei in the 1990s being a prime example. Moreover, the outperformance supports the argument for active risk management in investing.

It is worth noting that the performance deviations in Figure 2 are amplified by the violent market swings in March - April 2020. As a check on the disproportionate impact of Covid on the analysis, Figure 3 shows the same analysis for the Capped SWIX covering the eight years to December 2019. While the performance dispersion is clearly reduced, the findings above broadly hold for the pre-Covid period under review.

Figure 3: Capped SWIX cumulative performance covering pre-Covid period



The analysis covers the period 31 December 2011 to 31 December 2019

Source: Bloomberg, Terebinth Capital

The best of both

While the analysis is intuitive from a single asset class perspective, the value lies in viewing it through the lens of blending asset classes. The benefit of a multi-asset portfolio is that, as the name suggests, it has broad-based/balanced exposure to the various asset classes, which reduces the risk of missing out. In addition, a balanced portfolio blends high-vol asset classes with low-vol asset classes, which enhances diversification.

Importantly, by combining growth assets with income assets, the portfolio has some downside protection via the yield on defensive income assets. However, it can still catch up (if needed) to its return objective via the growth assets. Allocating the bulk of a balanced portfolio to income assets will result in the performance taking longer to catch up to the return objective following a large drawdown than when the portfolio can leverage off some exposure to growth assets.

Although time in the market has repeatedly been proven to beat timing the market, this analysis highlights that returns can be enhanced by active risk management. In addition, blending asset classes with distinct characteristics gives a portfolio the best of both – upside via growth assets and downside protection via defensive assets.

Glacier Research would like to thank Carmen Nel and Dumisani Ngwenza for contributing to this week's *Funds on Friday.*

Carmen Nel
Head of Multi-Asset
Terebinth Capital

Carmen coordinates the multi-asset strategy, working closely with the asset class specialists across equities, fixed income, and listed property. Prior to joining Terebinth Capital in 2023, she co-ordinated the asset allocation committee and worked as a macro and fixed income strategist at Matrix Fund Managers. Carmen started her career on the sell-side, having worked at Deutsche Bank, Citi and Bank of America Merrill Lynch. She spent the bulk of her career at Rand Merchant Bank, where she was co-head of the Global Market Research team. Carmen has a B Sc in Actuarial Science (UJ), B Sc Hons in Mathematical Statistics (UJ) and B Sc Hons in Advanced Maths of Finance (WITS). She is also a CFA charter holder with the CFA Institute and an FRM charter holder with the Global Association of Risk Professionals. She has 22 years of financial market experience.

Dumisani Ngwenza

Junior Portfolio Manager, Quantitative analyst

Terebinth Capital

Dumisani Ngwenza joined Terebinth as a Quantitative Analyst from Old Mutual Specialised Finance, where he was a Junior Quantitative Analyst, assisting in monitoring and managing interest rate management strategies and the investment guaranteed returns book. Dumisani holds a Master of Philosophy degree, with a major in Mathematical Finance from the University of Cape Town. This follows his Bachelor of Business Sciences degree, with a major in Actuarial Sciences. Dumisani contributes to oversight and development of in-house systems and process automation. His responsibilities include portfolio management, trade execution, risk monitoring and allocation, trade idea formulation and engaging clients.