



**smarterinsight™**

**Setting sensible expectations for investment returns**

25<sup>th</sup> October 2024

## Setting sensible expectations for investment returns

Man has the hardest job of all, the job of making decisions on incomplete data.

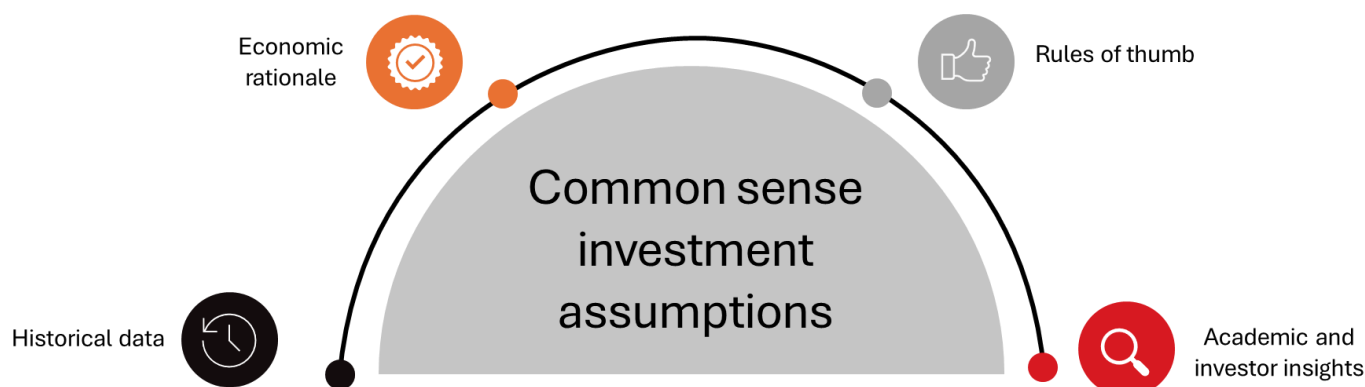
Henry Kuttner

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

As your financial planner, 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 objectives is built on reasonable expectations.

One important element of planning for the future is building a reasonable understanding of what an investment portfolio can deliver. We follow a logical framework (illustrated below) to achieve this, and following such a framework helps us to form 'central case' expectations of future investment returns. The words 'central case' is important here as these assumptions sit at the *centre of a wide range of possible outcomes*.

Figure 1: A logical framework for setting sensible expectations for investment returns



Source: Albion Strategic Consulting

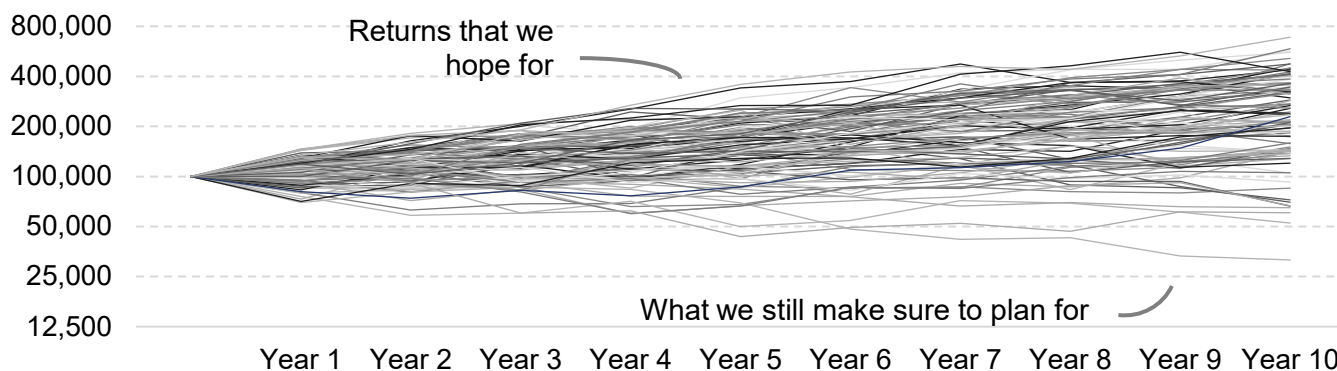
Investment returns, however, do not come in straight lines (i.e., the *average expected return*) and it is the sequence in which they occur that matters more. To illustrate this point, we have run an analysis using:

- The average calendar year return of global share markets<sup>1</sup> from the past 30 years (1994 to 2023) – which was an impressive **9.4%, before inflation**, and;
- The average volatility (a measure of how bumpy the ride was) over the same period of 18%.

The figure on the next page shows one hundred simulations of 10-year long investments using the same average return and volatility – you could say, 100 possible futures!

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

**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:

1. Have sensible expectations about the future returns that markets could deliver, and;
2. Meet with us each year and understand “*Your Probability of Success*” which involves a similar analysis but uses assumptions tailored to your circumstances and 1,000 simulations up until you are age 100.

Tough times may mean that you have to spend less or save more but part of our role as your financial planner is to identify and advise when this is necessary.

The longer you remain invested, the greater the opportunity for shorter term noise to subside and longer term expected outcomes to prevail. Remember, having a financial plan built on sensible assumptions and maintained through time gives you the best chance of achieving your financial objectives.

## Other notes and risk warnings

### Risk warnings

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