

Advanced Corporate Management

# The Investor's Perspective

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# Asset Classes

- Cash
- Bonds
- Equities (or stocks)
- Property
- Hedging

# Asset Returns

- Compounding
- Dividends/interest/capital value
- Fees/commissions
- Taxation
- Exchange rates
- Regression to the mean
- Dividends → return on capital → competition → ?

# Compounding Lessons

1 Over 25 years, \$1 invested  
At 4.6% bond annual return would be worth \$3.10  
At 8.8% equity annual return would be worth \$8.30

2 Over 10 years,  
10% annual return produces  
159% total return  
12% annual return produces  
211% total return

So (1) says asset allocation matters hugely  
(2) says even apparently small return  
differences matter too

# Portfolio Management

- Risk - principal; return
- Diversification
- Balance
- Inflation - real; nominal
- Asset duration
- Self managed or professional?
- Borrowing/leverage
- Dollar cost averaging

# Mutual Funds

- Diversification
- Professional management
- Liquidity
- Convenience
- Cost

# On Indexing

In the four years 1995-98, the Standard and Poors 500 index in the US outpaced 82% of mutual funds, while the Wilshire 5000 index outpaced 72%.

Over 15 years to 1998, the average large capitalisation fund returned 14.1% compared to 16.0% for the Wilshire 5000 Equity Index.

Only 33 of the 200 funds that survived the 15 years to 1998 outpaced the Wilshire 5000 index. The odds of fund superiority were thus a very low one in six.

# Illustrating Investment Growth

Annual return

Years until  
investment doubles

3%	24
6%	12
9%	8
12%	6

# Some Key Facts

- The overall market explains about 85% of the total return of most investors and funds
- Past performance has very little predictive ability
- Asset allocation explains 90% of differences in total returns
- A substantial majority of funds managers fail to beat the stock market index (after allowing for fees and taxes in funds)
- Top performing funds are invariably not top performing for long

# Remember

In the US today

- Dividend yields are historically very low
- Price/earnings ratios are still historically very high
- Earnings quality is under serious question for many companies
- Earnings growth is typically slower than in the second half of the 1990s
- All this despite the fact that stock prices are well below their peak levels

# Some Lessons

- Top performing sectors rapidly change
- Staying the distance pays off
- Absence from the market carries penalties
- Top performing funds change rankings rapidly
- Fads or following the crowd can be dangerous
- Emphasise diversification, portfolio allocation, persistence