Portfolio Analysis by the Calendar

The Problem with Arbitrariness

By: David Jeter, CFP®

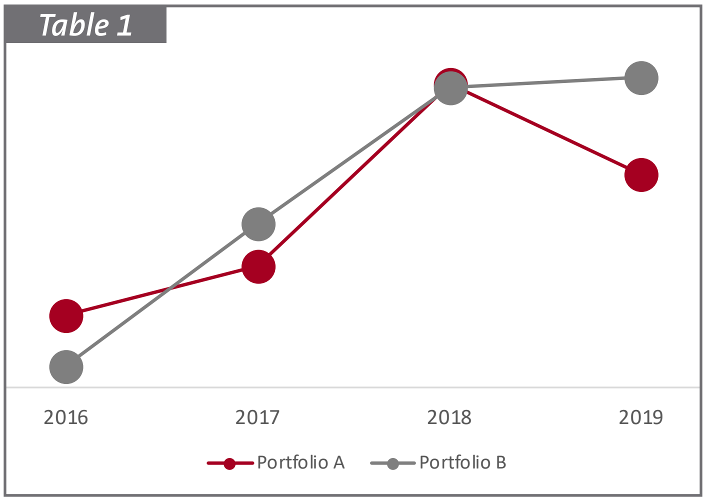
March 2019

"How did the market do last year?" "How did my portfolio do last year?"

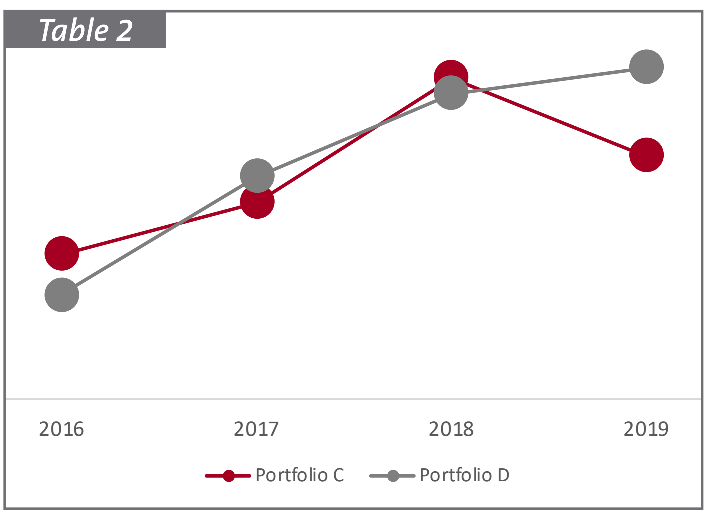
These are common questions people want to know the answer to; but what value does it provide for your long-term planning?

Consider the data in the following two tables. Each table displays account balance levels from real client portfolios from 2016 to 2019.

If you could choose Portfolio A or B in Table 1 to be yours, which would you choose?



If you could choose Portfolio C or D in Table 2 to be yours, which would you choose?



Portfolio A and C begin at a higher level and end at a lower level. Portfolio B and D start at a lower level and end at a higher level. All else being equal, one would certainly deduce that Portfolio B or D are the better choices.

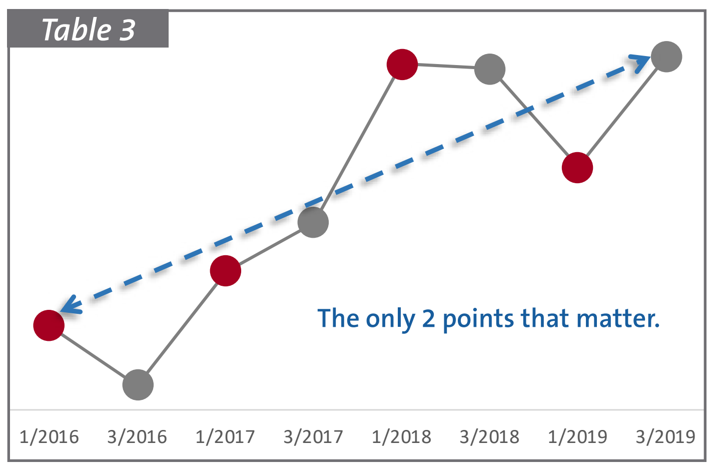
> *"There is no 12 month period that should be the basis for our investing mood."*
> *—David Jeter, CFP®*

However, this is a bit of a trick question because A and B are the exact same portfolio; C and D are the same portfolios.

The information I did not provide is that Portfolio A and C measure from January 1, 2016, to January 1, 2019. B and D measure from March 1, 2016, to March 1, 2019.

This exercise should strike you as pretty profound. A mere 60 days shift over four years changes the experience significantly. On the surface, one could deduce better investment acumen, a more aggressive profile, or even mere luck. Regardless of the reason, in hindsight the choice is obvious. But really, the choice is not one at all; it is the timing of when one decided to stop and pay attention.

In Table 3 below, Portfolio A and B are combined with data points of Portfolio B being shifted over to their proper placement in time.



Do you know why we choose to report calendar year returns? Because it is a convenient and easily grasped measuring period. It also happens to be completely arbitrary. Because Investing is a long-term proposition, there is no 12-month period that should be the basis for our "investing mood" or decision making. Keep in mind that arbitrary

Continued.

is not the same as random. The last day of the year every year is not random, but it is arbitrary. Annual returns are convenient, but provide little in the way of analysis of long term investing success.

When guiding clients, I will tell them they can expect returns each year within a quantifiable range based on their asset mix. This range will include some returns quite high and others negative, but likely they will never hit exactly average. Does a single annual return matter to an investor who is building wealth to last for years to come? Only in the same way that a single game's result should matter to an owner of a professional sports team with 82 games in a season, such as the NHL or NBA.

"Does a single annual return matter for an investor who is building wealth for year's to come? Only in the same way that a single game's result should matter to an owner of a professional sports team."

—David Jeter, CFP®

I readily admit I am "guilty" of showing clients calendar year returns for their portfolios. However, I know the full discussion we have concerning it just being a reference point for the bigger picture. For those who are do-it-yourselfers, I am not as confident that the whole perspective is understood. Consider this; if you did not pay attention to returns as of December 31, 2018, and you "Rip Van Winkled" your way through it and ran your numbers from March 1, 2018, to March 1, 2019, you would have assumed very little out of the ordinary.

The portfolio return that matters to investors is the one that will allow them to reach their goals without taking undue risk. It is the return that occurs over a full market cycle (and longer!), for this is the return that determines if you are on track.

If you would like to discuss the subject matter in this article or any question related to your financial planning, please contact David Jeter at djeter@alleghenyfinancial.com or 412.536.8012.