ET THE ECONOMIC TIMES

June 10, 2024

When a decade is a short time in the market

Synopsis
A study of the long-term returns of Sensex and equities highlight the volatility and significant variations over decades. It also questions the perception of gold as a safe haven asset.

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A week may be a long time in politics but even a decade is a short time in asset markets.

When we talk about various asset classes, we often mention expected long term returns, and sometimes in the passing, we also talk about the volatility of short term returns. But have you ever thought about what long term really means?

Sometimes we have vague notions like 5 years or 7 years is what long-term means. The question is: what does the data say?

Think Indian equity markets compound at 15-16% per annum?

You're right, of course: that HAS been the SENSEX return over 40+ years.

Nevertheless, what you may not know is these vary hugely not just year to year but over long periods of time.

Compounded annual returns each DECADE, starting 1980, have been 21.6%, 14.2%, 17.8% and 8.8% compounded. That means that Rs.100 invested at the beginning of 1980 became 700 in 10 years, whereas the same Rs. 100 invested in 2010 became only 230 rupees in the last decade. The difference can be as stark as that!

Rakesh Jhunjhunwala said, *"Not every year I make money. I make money in spurts, like 1989-92, 2003-07, 2009-11. In 1994-99, I wouldn't have made any trading income."* (from the book 'The Big Bull of Dalal Street')

Equity returns can be that very lumpy!

The Sensex gave ZERO returns from 1994 to 2003 — a period of nine years. But then went up more than 6 times in 2003 to 2007.

Returns can be as skewed as that.

Always step back, look at data, understand the big picture and you will get insights that you never will when you are caught up in trying to 'understand' day-to-day price movements.

You might think, *"Ah well, equities are a famously volatile asset class. I am sure certain other assets would give safer and more predictable returns."*

And your grandmother's favourite gold comes to mind.

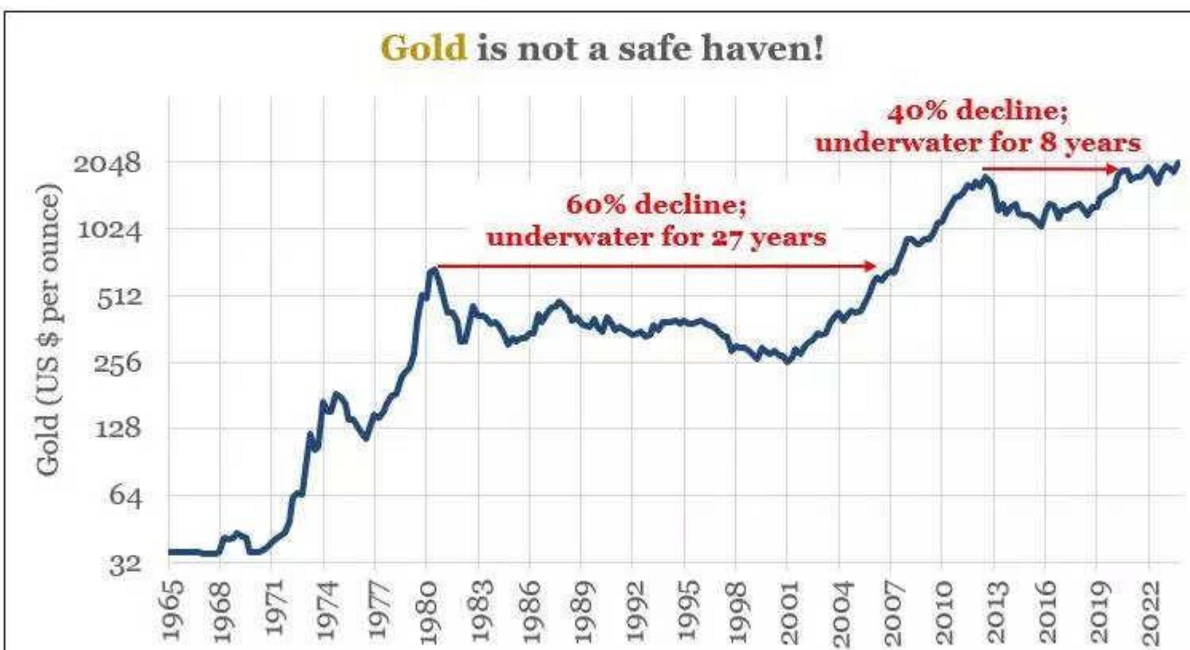
Gold: Safe Haven or not?

Gold has been the flavour of the year and phrases like 'inflation protection' and 'safe haven' have come back into vogue.

But what does the data show?

Gold did not reach its early '80s US Dollar price for a good 27 years; and had a 60% decline in the interim.

Then again, the 2012 high was not reached till 2020 with a 40% loss in between.



Source: First Global Research, Bloomberg

Safe haven? Doesn't look like it, does it?

Of course, for Indians, gold was a hedge against Rupee depreciation. The only accessible one. So the Rupee chart looks passable.

But now other global assets are also available for investment. And taking a wide-angle lens and looking at gold prices for 50 years gives a whole different picture from its safe haven image.

Looking at performance for 1 year, 5 year or 10 years even may totally mislead you.

Not just in absolute terms, but how has gold done versus equities…over the long term?

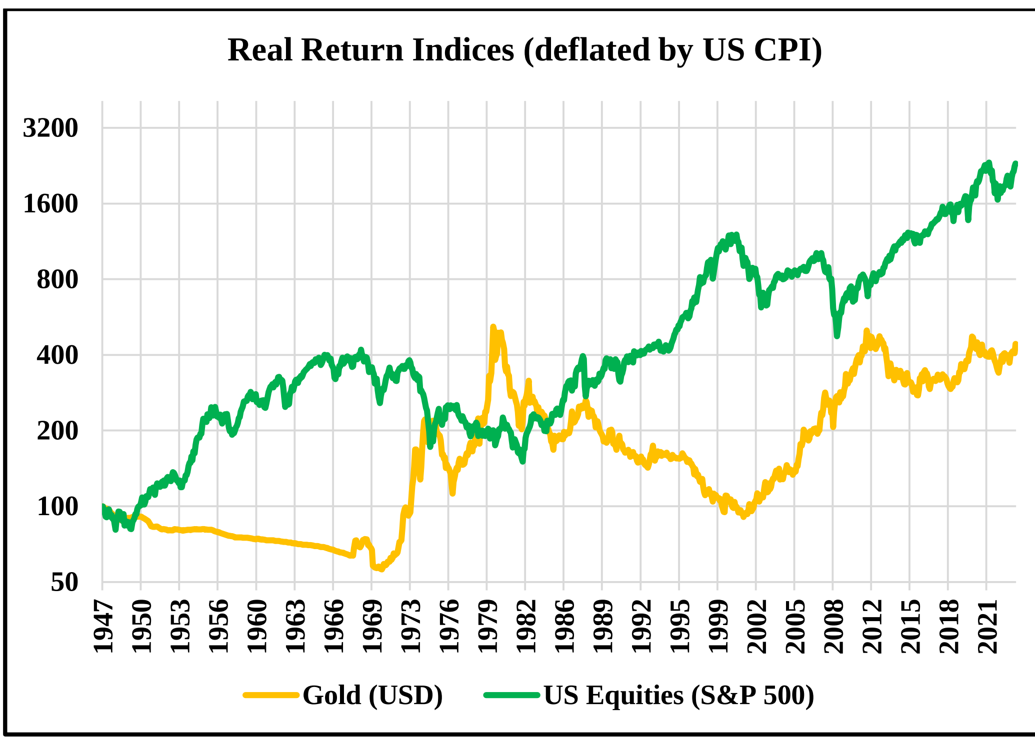
Does Gold provide better inflation protection than US Equities?

Data since 1950 shows that when adjusted for inflation (in real terms), gold has experienced a much steeper maximum drawdown (nearly 82%) compared to US equities (around 64%).

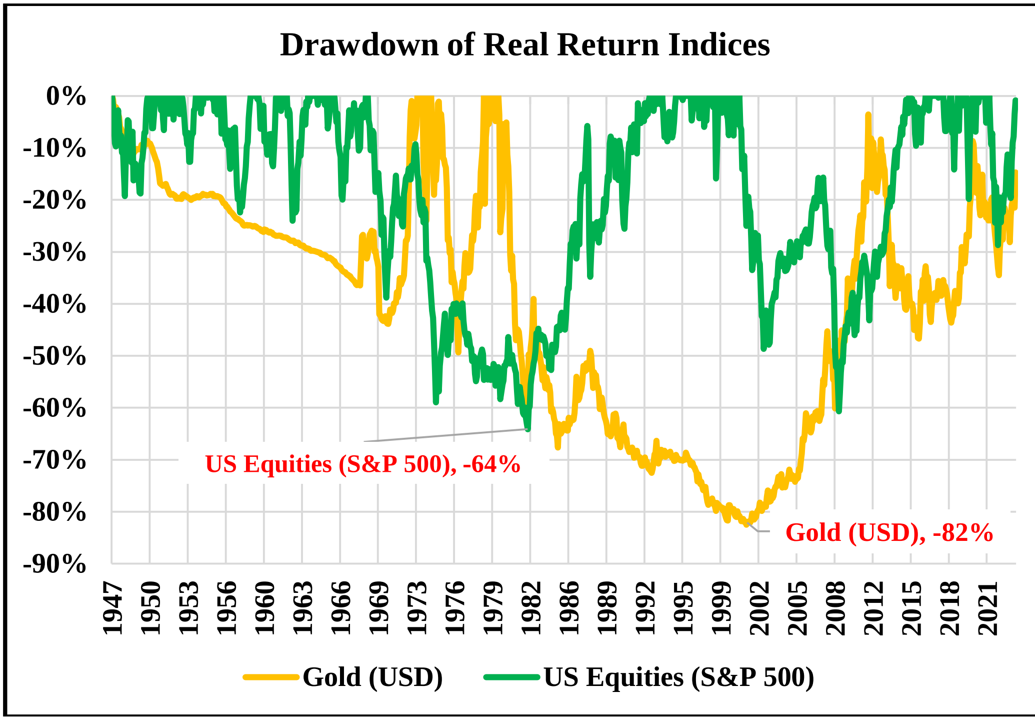
Even more compelling, the US equities real return index exhibits a generally upward trend while gold's real return index has seen significant swings.

Gold, in contrast to its reputation, has been no safe Haven, with bigger drawdowns than equities!

Hence, Gold can be part of your asset allocation but just not a very large part.



Source: First Global Research, Bloomberg



Source: First Global Research, Bloomberg

Really long-term data on equities and gold both show a very different picture from the general impression we hold.

Or another way of saying it is that a decade's data is not really long term in asset markets.

What about the assumptions on linkages between asset classes.

A question that comes to mind is:

Are Bonds and Equities Positively or Negatively correlated?

How to optimize asset allocation for that?

Most asset allocation recommendations assume a negative correlation between bond and equity prices meaning that if equities go down, fixed-income asset prices will go up.

The Indian bond market has not had the depth for long enough to make this analysis possible. Let us look at the behaviour of the US and the UK markets for now.

Where does this logic of negative correlation come from?

Bonds and equities HAVE been negatively correlated, at least in the US and the UK for the last couple of decades.

Yet again, here when you step back and use a wide-angle lens, the picture changes.

Contrary to popular belief, bonds and equities have NOT always been negatively correlated.

In fact, data shows that for a century i.e. from 1900 to 2000, they were mostly positively correlated!

The period of negative correlation from 2000-2020 was actually an anomaly in history.

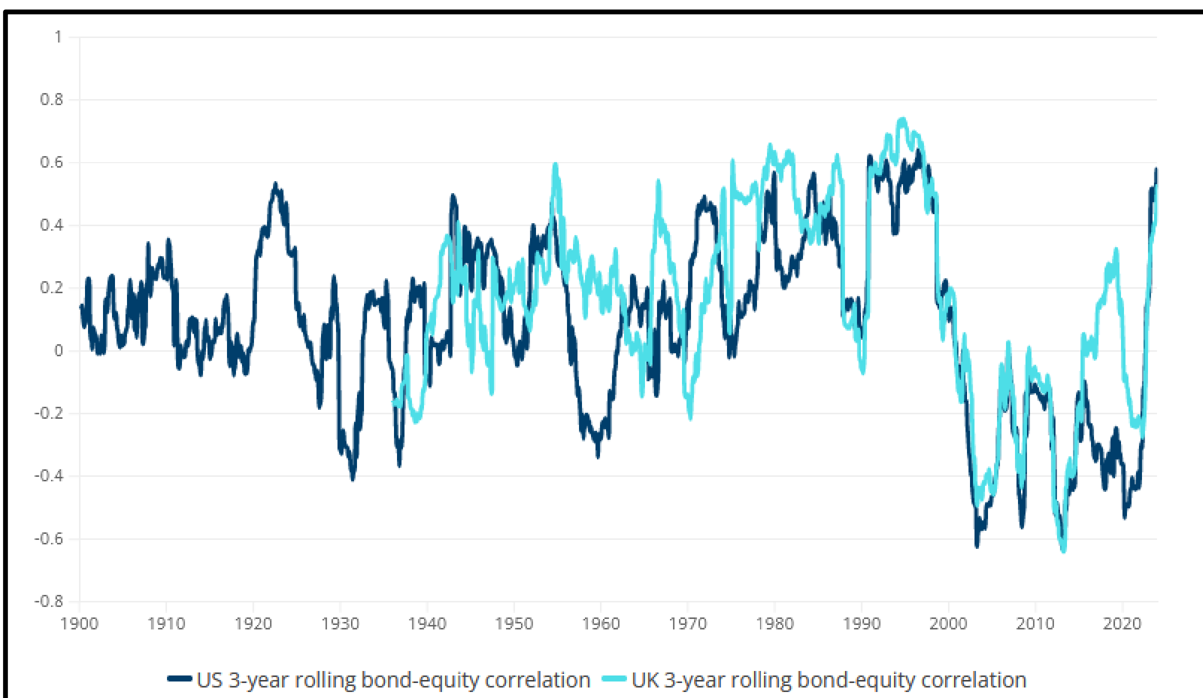
And our impression that this is the norm is only an example of RecencyBias.

However things have changed once again, driven by rising deficits, the transition to everything 'green' which has an inflationary impact, and higher inflation volatility.

Recent trends show that correlations have reverted to positive.

This shift underscores the importance for multi-asset investors to rethink their diversification strategies. Relying solely on a traditional 60/40 portfolio (60% global equities and 40% global bonds) is no longer sufficient.

Neither is an assumption that what happened in the last 10-15 years is the norm or can be extrapolated in any market.



(Harsh Shivlani also contributed this piece)