

A Bird's Eye View Sparrows Newsletter 2018

The Cost of Waiting on the Sidelines



Prospective clients are often anxious about the timing of setting up a new portfolio, and may look to justify staying in cash on the basis that “the equity markets are overheated and due for a correction” and “the fixed income markets yields are artificially low due to central banks’ bond buying programmes”.

The turn of the year presents a natural vantage point from which to look back and review the opportunity cost of being out of the market while trying to identify an optimal entry point.

Sparrows Capital has developed a suite of four relatively conservative US Dollar and Sterling denominated model ETF portfolios intended for trusts and charities. The primary objectives of these portfolios are long term capital preservation (non-equity and cautious portfolios) and limited capital enhancement (conservative and medium risk portfolios). In this letter we use these portfolios as a measure of opportunity cost.

Table 1: Sparrows Capital Wealth Preservation Suite - Cumulative Returns to 31/12/2017)

	USD ¹		GBP ¹	
	Cumulative Return		Cumulative Return	
	3 year	5 year	3 year	5 year
Non-Equity (0%Equity/75%FI)	3.9%	6.1%	5.4%	8.6%
Cautious (10%Equity/75%FI)	7.0%	12.7%	10.0%	17.4%
Conservative (25%Equity/73%FI)	12.0%	22.4%	17.1%	31.0%
Medium Risk (45%Equity/53%FI)	17.6%	34.2%	25.8%	47.3%
Cash Deposits	1.2%	1.3%	0.9%	2.0%
Inflation (CPI)	5.0%	7.4%	4.8%	7.5%

¹ Sparrows Capital Model simulated Total Return monthly performance from 01/01/2013 to 29/12/2017, reported in USD, net of ETF OCF, 40bps management fee, custody and trading costs, rebalanced quarterly.

US Risk-Free Rate Source: <https://fred.stlouisfed.org/series/TB3MS>.

US CPI Data Source: https://www.bls.gov/data/inflation_calculator.htm.

Balance of SAA comprises cash and gold.

¹ Sparrows Capital Model simulated Total Return monthly performance from 01/01/2013 to 29/12/2017, reported in GBP, net of ETF OCF, 40bps management fee, custody and trading costs, rebalanced quarterly.

UK Risk-Free Rate Source: <https://fred.stlouisfed.org/series/IR3TTS01GBM156N>.

UK CPI Data Source: <https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7bt/mm23>.

Balance of SAA comprises cash and gold.

It is immediately clear from Table 1 that market returns have significantly exceeded the risk free “cash” rates available in both currencies. Depending on the risk profile, the US Dollar portfolios outperform cash by 3% to 16% cumulatively over 3 years and by 5% to 33% over 5 years. Similarly, the Sterling portfolios outperform by 4% to 25% over the past 3 years and by 7% to 45% over 5 years.

At the same time, the return on cash investment has failed to keep track of inflation, meaning that the value of uninvested wealth has fallen in real terms by around 6% over the past 5 years in US Dollar terms, and by 5.5% in Sterling terms.

Attempting to time market entry is a form of market timing decision, and as we have seen time and again this is another way to damage returns. Academics such as Eric Chang and Wilbur Lewellen¹ have argued against it since 1984, and Wei Jiang also suggested in 2003¹ that timing markets is a chancy game.

Sparrows Capital has looked closely at this issue and has found data that is even more pessimistic. Recently, we reviewed the performance of several third-party managed portfolios and found that performance is just not up to par, with the single largest component of shortfalls being market timing decisions intended to reduce risk.

For clients who are nervous about taking the plunge, one way of overcoming the psychological hurdle is to cost-average – deploy the cash systematically in equal tranches over a predefined period. This reduces the dependence of future returns on a single entry point.

There is a well-known adage which states that *time in* the market beats *timing* the market. The cost of being out of the market is very real from the dual perspectives of value erosion and opportunity cost.

Raymond Backreedy



For more information on our philosophy, process or if you just want to challenge these observations, please get in touch.

info@sparrowscapital.com

+44 20 3714 4624

www.sparrowscapital.com

¹ [Chang, Eric C., and Wilbur G. Lewellen. "Market Timing and Mutual Fund Investment Performance." *The Journal of Business* 57, no. 1 \(1984\): 57-72.](#)

¹ [Jiang, Wei. "A nonparametric test of market timing." *Journal of Empirical Finance* 10 \(2003\) 399 – 425](#)

Disclaimer



This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Although all information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are subject to change without notice and the asset classes, the asset allocation and the investment instruments are only indicative.

Past performance of an investment is not a guide to its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in FX rates may have an adverse effect on the price, value or income of an investment. Furthermore, performance information may be based on simulations and/or be for illustration only.

This presentation is intended only for substantial investors who have the knowledge and understanding to enable them to assess the risks attaching to investment and who qualify as professional clients for the purposes of the rules of the Financial Conduct Authority. We would recommend that you take financial and/or legal advice as to the implications of investing in any of the products mentioned herein, including tax matters. Sparrows Capital Limited does not provide tax advice.

This document may not be reproduced or circulated without prior authority of Sparrows Capital Limited.
This document is not intended for distribution. © Sparrows Capital Limited, London, UK

Sparrows Capital Limited is registered in England and Wales under company number 08623416 and is authorised and regulated by the Financial Conduct Authority.

For more information

+44 20 3714 4624 | www.sparrowscapital.com | info@sparrowscapital.com