Staying The Course

“Stay The Course” is thought to be a nautical term for holding a constant tack amidst stormy seas. It also surely applies when looking back on a remarkable 2020 in the stock market: investors experienced a complete market cycle in just 12 months, with initial fervour giving way to utter despair, followed by an unending climb right back up again. Within the market, however, the moves were hardly uniform, as many dependable blue-chip Canadian pipelines, utilities, REITS and banks ended the year with price declines while information technology businesses sparkled. Investors may have experienced a wide disparity in returns on their securities and investment funds depending upon their personal mix.

Entering 2021 many might feel compelled to move on from their investment laggards and hop aboard recent winners. Individual investors are not alone in feeling the urge, as endowments, foundations and pension plan boards frequently take similar action in this manner. Plenty of empirical evidence, however, indicates a better bet is to stay the course after a difficult stretch. A 2014 study from Vanguard[1] tested a strategy of “Performance Chasing”, selling underperforming equity funds to buy outperforming ones, as judged by trailing three-year performance. They calculated the performance of this strategy over ten years and compared this to a simple “Buy and Hold” approach, and then ran the same comparison across numerous categories of fund. The results were the same regardless of fund type – better returns came from the Buy and Hold strategy than the Performance Chasing method, as recent winners frequently encountered a soft spell while recent losers regained form.

Median Return	Large Growth	Large Value	Small Growth	Small Value
Performance Chasing	4.3%	4.7%	5.7%	5.8%
Buy and Hold	7.1%	7.0%	8.6%	9.3%

In a similar vein, a 2018 report from the Journal of Financial Planning[2] studied the impact of selling disappointing investments at different pain points that varied with individual risk tolerance. In different scenarios investors would panic and sell if they experienced either a sudden one-month drop or a specified cumulative drop over four months, with the magnitude varying with risk aversion, and then re-enter the market either after a six month cooling off period or a significant market rise. Five different investor profiles were assessed using a ten-year span, and the outcomes ranged from a cumulative 7.9% to 13.1% negative impact to performance from moving out of losers rather than simply staying the course. This estimated “cost of emotional investing” directionally supports the Vanguard study conclusion that it is usually best to stay put rather than chase recent returns.

2020 was an unforgettable year in many ways, and the disparity in returns across securities and equity funds was enough to give anyone pause, with some investors treated with fair winds and others still feeling seasick. Regardless of which boat you are in as the new year begins, data suggests that sitting tight and keeping a steady hand on the tiller should lead to a better outcome than jumping ship midstream.

[1] "Quantifying The Impact Of Chasing Fund Perforance", Brian Wimmer, CFA, Vanguard 2014
[2] "Using A Behvavioral Approach To Mitigate Panic and Improve Investor Outcomes", Steven Wendel, Ph.D, Journal of Financial Planning, February 2018