

What is the Average Return on Equity Markets?



Following a couple of conversations that I have had recently, I thought that I would try to explain why average returns on Equity Markets are not consistent returns.

Investing is a strategic approach to growing wealth and making a profit on money.

Return is the positive or negative result of an investment, expressed as a percentage of the initial investment. It is the performance of investments over a specific period and is usually expressed as an annual rate.

This article will look at the concept of average share return and the factors that influence investment returns. We also discuss the significance of long-term investing, and market timing, and how to set realistic expectations for investment returns.

Understanding Investment Returns

Investment returns play a crucial role in evaluating the success of an investment strategy. It is important to note that return is different from outcome.

While return is expressed as a percentage, outcome is a numerical number - The final result. By calculating returns, it is possible to compare different investments more effectively, regardless of the amount invested.



The main goal of investing is to make a profit. Returns can be generated through various means, such as price increases, dividends, and interest payments.

It is essential to evaluate the returns on investments over time to gauge their performance.

A benchmark, like an index such as the S&P 500, can be used to compare the performance of different investments.

Historical Average Share Returns

To understand the average share return, consider the historical data. **Over the last century, the average return on equities in the United States has been 9.81% per year.** However, when accounting for inflation, the average return drops to 6–7%. It is important to note that this average return is not achieved consistently every year. In fact, **only 13 years fall within the 8–12% return range.**

The Impact of Market Volatility

While the average return on shares may seem promising, it is crucial to consider the impact of market volatility.



Stock prices can fluctuate significantly from year to year, resulting in varying returns.

For instance, there have been years of significant losses, such as the 2008 crisis, which resulted in a 38.5% decrease in the S&P500, whilst some developing markets like Vietnam, were down 60% or worse.

However, when it comes to long-term investments, market volatility becomes less of a concern. Over an extended time horizon, the market tends to recover from downturns and deliver positive returns. Short-term fluctuations may impact your returns if you have a short investment horizon, but they are less significant for long-term investors.

With the geopolitics and market volatility of today, it is easy to see this a disaster, but in a couple of years' time, this will look like 'noise'.

Beating the Market

Warren Buffett is one of the most successful investors of all time, managing Berkshire Hathaway for more than 50 years. BRK has consistently outperformed the S&P 500 index. He says his success is down to his simple and effective investment strategy.



The approach is based on buying what he knows and understanding the fundamentals of the companies he invests in.

He argues for taking a long-term perspective and not letting market fluctuations influence you. His success really shows the power of a patient and long-term investment strategy.

Time in the Market

While many investors attempt to time the market to maximise their returns, research has shown that market timing is a challenging feat. Predicting the peak or bottom of stock prices is nearly impossible, even for expert investors. Instead of trying to time the market, focus on the amount of time you spend in the market. If you believe you can successfully time the market, these articles may offer pause for thought.

<https://www.strategic-expat.com/post/stock-market-bottoms-part-1-what-signals-a-stock-market-bottom>

<https://www.strategic-expat.com/post/is-market-timing-a-viable-investment-strategy>



Time in the market is more crucial than market timing.

Missing out on the best trading days can significantly impact your returns. For instance, if you missed the ten best trading days over a 30-year period, your returns could drop from 9% to 6%.

The majority of profits are generated during a small number of trading days, emphasising the importance of staying invested.

A recent example is that on 17th August 2023, the S&P500 was at 2370, and has drifted downwards to a low of 4117 on October 27th. In the 5 trading days to 3rd November it has

recovered to 4358- a gain of 5.85% in a week (and arguably a return which takes an average of more than 7 months to achieve).

Warren Buffett famously said, ***“The stock market is a device for transferring money from the impatient to the patient.”*** Buffett’s long-term investment approach has yielded an average return of 20% since 1965.

Short-Term Gains vs. Long-Term Returns

Short-term gains can be exciting, but it is essential to differentiate between short-term trading and long-term investing. Short-term investing is fast-paced, time-consuming, and often driven by market psychology. It focuses on immediate price movements and the potential for quick profits.

On the other hand, long-term investing seeks realistic and statistically proven returns. While it is possible to achieve higher returns than average, but consistent long-term investing is key.

The Lower Risk of Long-Term Investments



One of the key advantages of long-term investing is the reduction of risk over time. With an investment horizon of a decade or decades, the likelihood of losses decreases significantly.

Looking back at the last eleven decades, losses have only occurred twice.

With a well-diversified portfolio and a fifteen-year or longer investment horizon, positive returns have been consistently achievable since 1950.

The Limitations of Historical Performance

While historical performance provides valuable insights, it is essential to recognise that past performance does not guarantee future results.

Various factors, such as anomalies or market bubbles, can impact investment returns. The dot-com bubble in 1999 and the housing bubble in 2008 significantly influenced market performance. More recently, Covid 19, the war in Ukraine, and the HAMAS Israel conflict have all dulled markets and impact on short-term gains.

When evaluating historical data, it is crucial to consider inflation-adjusted returns as well. Real average returns account for inflation, providing a more accurate representation of your

purchasing power. By understanding the limitations of historical performance, you can set realistic expectations for your investment returns.

Setting Realistic Expectations

It is natural to aspire to earn higher returns on your investments. While it is possible to achieve returns greater than the average, it is important to approach investing with realistic expectations. Historically established returns, ranging from 5% to 8%, serve as a reasonable benchmark for most investors.



Rather than focusing solely on achieving high returns, prioritise long-term investing, diversification, and staying invested through market fluctuations.

Remember that investing is a long-term journey, and patience is key to achieving your financial goals.

Understanding that average returns are not consistent returns is crucial for evaluating the success of your investment strategy.

While historical data provides insights into average returns, it is important to consider factors such as market volatility and the limitations of past performance. Long-term investing, staying invested, and setting realistic expectations are key to maximising investment returns.