

How much can you rely on past performance?

You will often hear it said that today's top-performing funds have a better-than-even chance of being tomorrow's poor performers, and vice versa. It's been repeated so often that few people actually question its reliability.

One person who did question it was Australian university finance student V Soucik; he wrote a PhD thesis on the subject. For his thesis, he looked at the rolling returns (for periods ranging from one month through to five years) of several hundred Australian fixed interest and share fund returns from January 1985 to December 1999. The topic of his thesis was *Finding the True Performance of Australian Managed Funds*.

Not only did he find that funds don't necessarily move from one end of the rankings tables to the other, but that there is a generally symmetrical pattern to performance predictability –and more so for shorter rather than longer timeframes.

That is, if you look at a fund's comparative performance over a shortish timeframe such as two or three years, there's a reasonable chance that the following 18 months' to two years' performance will also be similar. He found this was especially so for the top and bottom performers.

There is a certain amount of logic to this when you think about it. A manager who's near the top of the field doesn't have to make any overly aggressive moves to stay there, he just has to maintain a reasonable degree of consistency. However, a fund manager who's in the bottom quartile can only get out of there by taking some fairly bold positions. That's a high-risk strategy with no guarantee of success.

Past performance may be no guarantee of future performance, but if you can analyse the performance, you are in a better position to gauge whether you think it's likely to continue.

To use a sporting analogy, once the rugby season's well underway, there's no guarantee a team will win its next two games just because it won the last three. However, if you look more closely at such things such as whether the past results were due more to skill or luck, whether the key players from the last three games are likely to be playing again, whether the team is training properly, etc, then you should be able to make a more informed forecast of how well they can be expected to go.

So the next time you hear it said that today's winners are tomorrow's losers, you've every right to be a little sceptical.

ENDS