Topic 2: Investment Return Vs Investment Performance

Your investment return is an absolute number, while your investment performance is a relative measure.

Investment performance is a function of both investment return and investment risk.

For example, your total Self-Managed Superannuation Fund (SMSF) may have had an investment return of 9.51% over the 12 month period to 31 May 2017. That's a specific number.

But how does that compare to the median return of all other SMSFs over the same period?

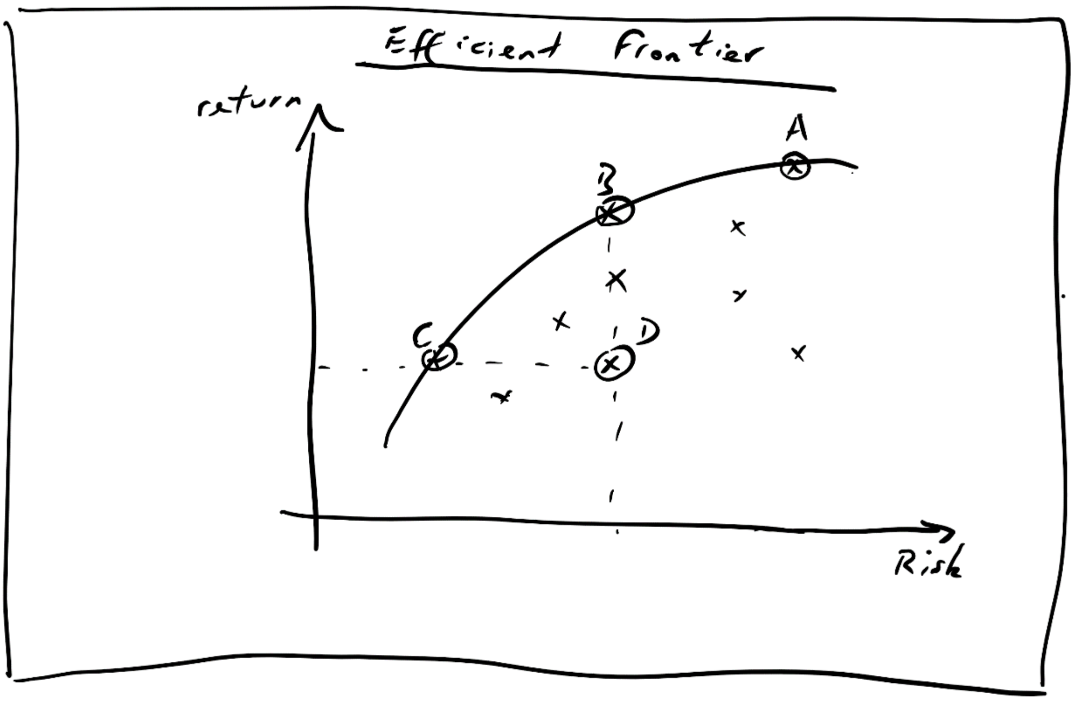
Perhaps more importantly, how does that compare to the median of all other SMSFs which invested in a similar way to you (similar risk) over the same period?

Could you have achieved a comparable return with less concentration risk, or less exposure to growth assets such as shares?

Is your return repeatable or was it due to good luck?

The Efficient Frontier

The concept of an 'efficient frontier' was created by Harry Markowitz in 1952.



In the above sketch we have plotted a number of funds with their returns, and the level of risk they took to achieve their returns. Consider 4 investors and their total SMSF performance, A,B,C, and D.

We can see that fund A has outperformed fund B and fund C, so can we say that fund A has been "better" than them?

No we can't. Investor B and Investor C may have a very different financial situation than investor A. Perhaps they are already fairly financially secure and are likely to meet their lifestyle goals if they achieve a moderate return. Why would they take on more risk than they need to?

What we can say however, is that Fund B has performed better than Fund D. For the same amount of risk, Fund D could have achieved a higher return. There is something in the approach that Fund B has used that has delivered a higher return over this period.

We can also say that Fund D could have achieved the same return whilst taking less risk (Fund C).

The "efficient frontier" is the curved line. The funds A,B and C all fall on this curve, and they were the funds which achieved the best returns for the amount of risk they took.

Every SMSF investor should want to be on the efficient frontier, because that's the return they are entitled to, given the amount of risk they are prepared to take.

Even an increased return of 1% pa would lead to a better lifestyle, greater legacy, longevity of wealth or whatever your goals are.

So Investor D would benefit by asking themselves "Did I get the return I was entitled to, given the amount of risk I took?" and perhaps "Given the asset allocation I want to have, what other approaches are available to me? Could I perhaps benefit by including something else in the mix which may lead to better outcomes over time?"