

Brief Guide to The Significance of Past Performance

This guide summarises the findings shown in the FSA Occasional Paper Series 9¹: Past Imperfect? The performance of UK equity managed funds - August 2000

The paper asks the fundamental question:

“Is past performance any use in determining future performance for retail investors”?

Study 1

A simple analysis was undertaken by WM Company (1999), in comparing active and passive fund management. They examined funds in the top 25% of performers over five year periods in the UK Growth and Income Sector for a period of 20 years (1979 to 1998). The proportion of these funds that remained within the top quartile was then examined.

The general result of this analysis was that there were no more funds still in the top quartile than would be expected by chance. The conclusion is that good performance is of no use in predicting the future.

Phelps and Detzel also conducted studies of US fund managers and concluded:

“past performance is of no use in picking tomorrow’s winners or avoiding losers”.

Study 2

A study by Quigley and Siquefield (1998) focused their research on whether past performance is a good predictor of the future.

They took monthly returns on all UK equity unit trusts that were in existence at any time over the period 1978-97. The authors formed equal-weighted portfolios of funds based on their performance ranking, by decile, over an initial year. The performance of each portfolio over the following year was then examined.

The authors found that, as an investment strategy, reforming one’s portfolio each year with last year’s top 10% of funds would not produce higher returns than a simple buy and hold strategy.

They found that low decile portfolios were found to have persistently poor subsequent annual performance.

They summarised their finding as follows:

“losers repeat, winners do not”

The Occasional Paper concludes:

“Literature on the performance of UK funds has failed to find evidence that information on past performance can be used to good effect by retail investors in choosing funds. The general pattern is one in which investment performance does not persist.”

¹ By Mark Rhodes, an associate in the Economics of Financial Regulation Department at the Financial Services Authority (August 2000). <http://www.fsa.gov.uk/pubs/occpapers/OP09.pdf>

If past performance is no guide to selecting funds, what should you do?

Understand your attitude to risk.

Build a well-diversified, low-cost, asset class portfolio, using index and passive funds. Accept the market rates of return and steer clear of actively managed funds.

For more information, please go to the section of our website entitled "How we invest". You may also find our other 'Brief Guides' of interest. They can be found by visiting our Downloads page.

Risk Warnings

The value of your investment can go down as well as up and past performance is no guarantee as to future performance.