A Word on Portfolio Performance and Benchmarks

Comparing portfolio returns to a benchmark can be a useful exercise for monitoring the efficacy of an investment style. It is imperative, however, that an appropriate benchmark be referenced.

Often investors erroneously compare their personal returns with an individual company stock or a broadly referenced stock index like the S&P 500 or the TSX 60, when in fact only a limited portion of their savings is allocated to the capital risk and volatility of corporate stocks and bonds. For example, if one were to hold 100% of one's savings in a basket of corporate stocks and debt, the portfolio performance might track closely with a broad stock market index: rise with market gains in up years, but also plunge with market losses.

A large exposure to violent capital swings is generally undesirable and dangerous to financial health and stability—especially the older one becomes, the more of our life savings we have already amassed, and the less lifetime we have left to make back losses. It is also particularly dangerous during the increased volatility of secular bear environments where price risk is very high, loss cycles steep and dividend yields unusually low.

The most common approach to smoothing capital volatility is to reduce or limit equity market exposure and concentrate savings in government bonds, guaranteed deposit notes and other investment quality fixed income holdings (that do not typically increase or fall with stock markets) while holding a smaller portion, in corporate equity and debt assets that do. This type of balanced asset allocation, 'long always' approach, is designed to gain less than stock indices in up years (because only a portion of the capital is participating in rising risky markets). The approach is also expected to fall less than the overall market in down years (because only a portion of the capital is participating in capital losses).

An alternate investment method is known as an 'absolute return' approach where one does not design portfolios to track with the ups and downs of equity markets, but rather to protect capital from losses and garner positive compound returns through full market cycles. This 'absolute return' approach is designed to be a very different experience than the conventional long always method, and is the approach we follow at Venable Park.

An Absolute Return Benchmark tracks the available savings deposit rate each year, plus an additional return percent on top of that reference rate. At Venable Park, our Absolute Return Benchmark target is the 3-month Canadian Deposit Offer Rate (CDOR—which was 0.9% as at December 2016) + 2% annually (net of fees) over a full market cycle (roughly 5+ years).

To give a sense of how our results have compared to date with the Absolute Return Benchmark, as well as a Long Always Benchmark (for those who are curious how our approach has compared with conventional methods in terms of volatility and returns), we chart VPIC's $1m+ 60/40 account returns (net of fees) as compared with the Long Always (gross of fees, in red) and the Absolute Return Benchmark (blue). All numbers are updated annually and can be viewed on our Venable Park website, 'Our results' tab.

If you have questions, or would like to discuss any of this further, please let us know.

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