FEBRUARY 2018

THE COMPARATIVE PERFORMANCE OF DIFFERENT SAVINGS STRATEGIES THAT USE FRENCH INSTRUMENTS

SUMMARY

amf-france.org

AUTORITÉ DES MARCHÉS FINANCIERS

AMF

FINANCIAL INVESTMENT - THE BEST STRATEGIES OVER THE PAST 30 YEARS

The Autorité des Marchés Financiers has produced a study comparing the returns on a number of different investment strategies in order to discover the most successful strategies since 1987. The study focuses on the performance of risk-free investment vehicles, such as the Livret A[1], and of equities and bonds, and on the real returns on these investments after charges and taxes.
This study covers multiple strategies, investment horizons and start dates to better identify the net real returns for savers and to raise awareness of the returns that financial savings can actually deliver. It notably incorporates assumptions of regular savings flows over long periods.

This summary provides an introduction and brief presentation of the main findings of the study, which is available in full on the AMF website.

1. BENCHMARK STUDY DESIGNED FOR FINANCIAL EDUCATION

1.1.1. A paradox between a quest for return and a mistrust of financial investment

Which investment vehicles and strategies have performed best over the past thirty years? This is a particularly important question given that since the financial crisis a significant proportion of French savings has been invested in vehicles that offer low volatility but also low returns. In 2016 French households placed 53 billion euro in cash and deposit accounts - just over the 2011 record of 52.9 billion[2].
In parallel, many investors were attracted by the often-unrealistic promises made about complex and highly speculative products (e.g. forex trading and binary options) or unconventional types of investment (e.g. diamonds, manuscripts or rare earths). Such offers, which omit to mention a high risk of loss that may exceed the initial capital investment itself, can turn out to be total scams[3].
Surveys of French households tend to reveal that they hold a low and pessimistic opinion of financial investment. Herein lies one of the reasons for the fall in retail shareholding in France and an increase in the country's wariness, if not outright mistrust of, this form of investment since the 2007-2008 financial crisis. Hence it was decided to raise public awareness of the true returns that can be achieved over the long term, via a reference document,whilst increasing the level of financial literacy. Since more long-term resources are needed to finance the economy, and since banking and insurance vehicles are able only in part to meet this requirement, this study provides new food for thought.

1.1.2. Focus on savings strategies

The study describes the performance an individual can obtain using a range of different savings strategies. The three standard investment vehicles considered are: **Livret A**, **French sovereign bonds** (10-year constant-maturity OAT fungible Treasury bonds) **and French CAC 40 listed equities**. Performance is observed between **December 1987 and July 2017** and takes account of **charges and taxes[4]**. However, this performance is not to be considered as an indication of future performance.

[1] The Livret A is a regulated French cash savings product with terms and conditions (cap and return, which is completely exempt from income tax and social security charges) set by the French government.
[2] Banque de France, national annual report.
[3] See AMF-CSA (2015) and the many AMF press releases referenced in the Bibliography, notably those dated 31 March 2016 and 27 January 2016.
[4] When it comes to taxes, we have applied a flat tax of 30% (including social security contributions) to the income generated by all instruments except Livret A. The calculations presented apply a simplified form of taxation (the virtues of which will doubtless be felt in the future) to the returns witnessed in the last 30 years.

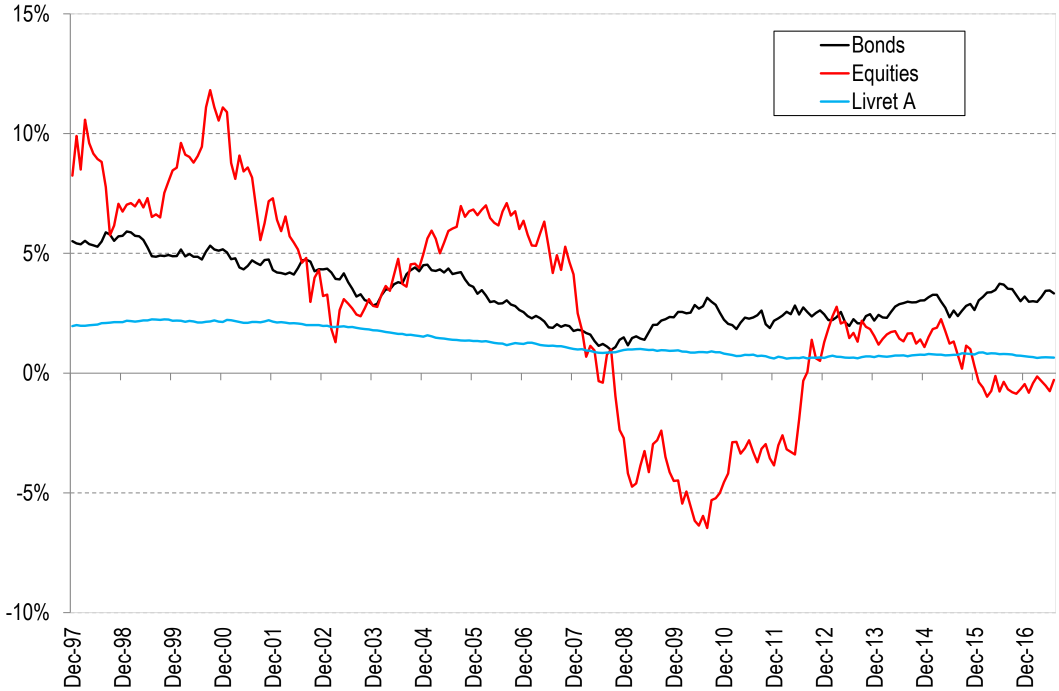
The study departs from existing academic literature by not simply comparing investment vehicles but also presenting several innovations:

- It examines not only the performance of one-off investments but also, more realistically, the returns a saver might expect at the end of a long-term, regular investment strategy;
- It takes inflation, charges and taxes into account to identify net real return;
- It examines investment strategies that include arbitrage between the investment vehicles under study;
- It examines different investment horizons and start dates to avoid vintage effects (if the start date is during a market bottom, for example, this may display deceptively good results).

2. MAIN FINDINGS

Scenario 1 - one-off investment at the start of the investment period

Finding: Between 1987-2017 for an investment over a 10 year horizon, the average real annualised return (net of inflation, charges and taxes) was **3.3% on bonds, 2.7% on equities and 1.3% on Livret A.**



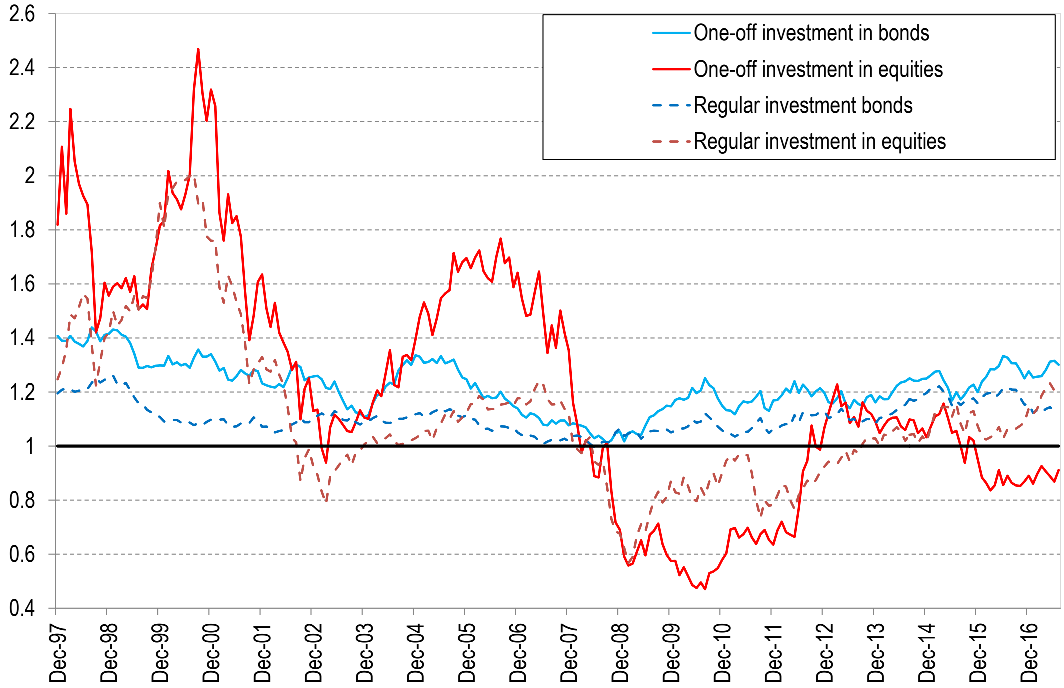
10-year annualised real return on French bonds, equities and Livret A (%)
Charges and taxes included *(Source: Datastream, AMF calculations)*

Comment

If a saver made a one-off investment at the start of the period, average annual equity and bond performance would have been 100-200 basis points (bp) above that of a Livret A after 4 years (after charges and taxes). For example, if the investment horizon was 10 years, the annual return on equities would have been slightly more than 140 bp better than that on a Livret A, and the return on the bonds more than 200 bp better. The continuing slide in bond yields pushed debt security performance to exceptionally high levels over the period (regularly outperforming equities on average once charges and taxes are taken into account) but these results cannot be extrapolated for future use (since if rates remain close to zero or rise, this will necessarily impact the value of debt securities).

☐ Scenario 2 - regular monthly investment

Finding: One-off capital investment and regular investment in the market are two distinct scenarios that present different performance profiles. Past and expected future performance as presented to the client must therefore take this into account.

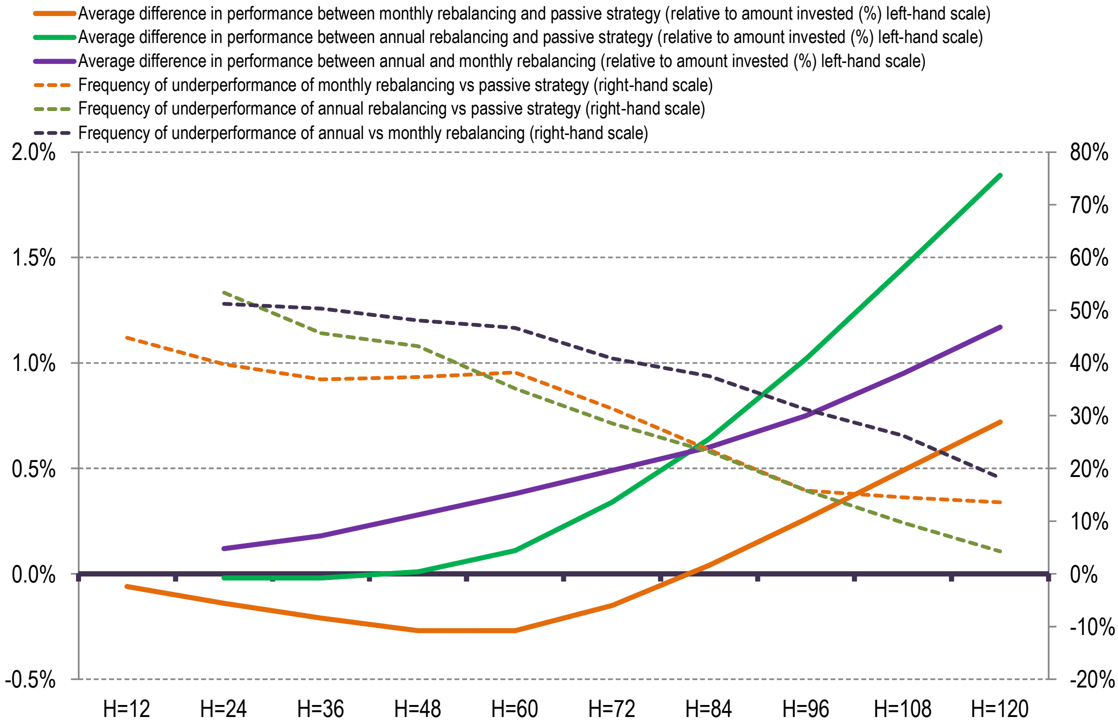


Equity and bond performance compared with Livret A - based on one-off or regular investment, a 10-year investment horizon and including charges and taxes
(Source: Datastream, AMF calculations)

Comment:
This scenario considers monthly investment in equities, bonds or Livret A with a 10-year horizon. It also examines a one-off investment at the start of the period in any of these vehicles. The real amount obtained at the end of the period is calculated for each method (one-off or regular investment) and for each investment vehicle (equities, bonds and Livret A) and includes charges and taxes. In each case the amount earned at the end of the period from the investment in equities or bonds is divided by the amount earned on Livret A.

☐ Scenario 3: mixed portfolio split equally between equities and bonds

Finding: the study shows the advantages of an active portfolio rebalancing strategy with a regular sale of the outperforming vehicle and strengthening one's position of the underperforming vehicle in order to maintain a constant weighting. A passive strategy that allows portfolio composition to fluctuate freely in line with vehicle performance produced significantly lower returns. Annual rebalancing is sufficient to generate the outperformance inherent in an active strategy: the investor automatically invests counter-cyclically (realising a capital gain on the outperforming investment vehicle and buying more of the underperforming vehicle). **The longer the investment horizon, the greater the outperformance: the average difference being 1.9% (above the passive strategy) if the investment horizon is 10 years.** The number of times this strategy outperforms the passive strategy increases dramatically as the investment horizon lengthens (in 96% of cases over 10 years).



Comparison of passive, monthly and annual rebalancing strategies over different investment horizons, based on monthly investment (50/50 initial allocation), including charges and taxes
(Source: Datastream, AMF calculations)

3. CONCLUSION

The study shows the performance that can be obtained by investing regularly in the financial markets. By deviating from a standard analysis of the return on a one-off investment and offering stylised assumptions of charges and taxes we have sought to provide **historical results for individual savers that are closer reflexions of real-life outcomes.**

While these results are not to be considered as forecasts, they do show the performance of the major financial asset classes over the past thirty years from an individual investor's viewpoint. Although circumstances have worked historically in favour of bonds since falling interest rates have pushed their value upwards and the equity markets have seen their moments of volatilty, **equities have nevertheless delivered broadly comparable returns to those of bonds**. The study also quantifies the benefit of rebalancing diversified portfolios invested in both equities and bonds. Over the same period, a regular portfolio rebalancing strategy (selling the securities that have increased in value and buying more of the securities that have dropped in value) can produce a rebalancing premium which, while not large in absolute terms, appears to be relatively constant over the period.