FosterDenovo
Private Wealth

Market briefing

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Investment outcomes and investment performance: why understanding the difference is important

When discussing investing, two terms often arise that can seem interchangeable: 'Investment outcomes' and 'investment performance'. While they are related, they refer to different aspects of the investment process. Understanding the distinction between the two is crucial for investors looking to make informed decisions and evaluate their portfolios accurately, in line with their individual goals. We'll explore the key differences between investment outcomes and investment performance, shedding light on their individual significance in the investment world.

Investment performance: measuring success

Investment performance refers to the measurable results of an investment over a specific period. It is typically quantified in terms of returns – i.e. how much the value of an investment has increased or decreased relative to its initial amount. This can include various metrics like:

Total return
The change in value of an investment, including both capital appreciation (price increase) and income (such as dividends or interest).

Annualised return
A smoothed rate of return that expresses the average yearly return over a given period, allowing for comparisons across different timeframes.

Risk-adjusted return
This considers the level of risk taken to achieve a particular return, commonly measured using metrics like the Sharpe or Sortino ratio.

There's no denying that performance is important. After all, the primary function of investing is to generate returns. A solid performance record can help investors build wealth, protect their purchasing power from inflation, and secure future financial needs.

Here are some reasons why performance is critical:

Measuring success
Investors use performance as a gauge to measure how well their investments are doing relative to benchmarks or market expectations. It provides clear, numerical evidence of an investment's growth.

Risk versus return
Performance metrics allow investors to assess the risk they've taken on relative to the returns they've earned. A well-managed portfolio should provide competitive returns without excessive risk.

In essence, performance is a quantitative measure of how well an investment has done in achieving a return relative to a historical performance.

Investment performance can be influenced by several factors, including market conditions, the timing of investment, and the specific choices made by the investor or fund manager.

Investment outcomes: aligning with goals

However, performance in isolation isn't the complete picture. Performance provides investors with a concrete way to assess whether their investments are growing and how well they compare to benchmarks or similar investment options. However, a strong track record doesn't guarantee current or future success for every investor.

Performance does not necessarily tell you everything about the investment experience. Just because an investment has performed well in terms of return, it doesn't mean the investor's objectives have been met or that the risk taken was appropriate, nor does it address how well an investment aligns with specific financial goals.

Investment outcomes refer to the actual real-world results an investor seeks to achieve based on their own specific financial goals. These outcomes are less about the numbers and more about the investor's personal financial objectives and how well their investments support those objectives. Investment outcomes can include:

Achievement of financial goals
Whether the investment has helped an investor meet specific goals, such as saving for retirement, purchasing a home, or funding education, using understandable benchmarks.

Long-term wealth building
Whether the investment strategy has contributed to growing an investor's wealth over time in a way that aligns with their broader life plans.

Financial security
The degree to which an investment portfolio has provided the stability and protection needed to support the investor's lifestyle and needs, particularly in times of market volatility.

Unlike performance, which focuses on quantitative returns or hard facts, investment outcomes are more qualitative and personal and therefore can vary greatly depending on the individual's goals.

For example, two investors might have similar investment performance (returns), but their outcomes could be very different. One investor might have been saving for retirement, and their returns help them meet that target. Meanwhile, the other might have been trying to save for short-term expenses and could have needed more liquidity – thus, their outcome would be different, despite similar performance metrics.

Investment outcomes are about whether the chosen investments help an investor achieve their personal financial goals; for example, retirement, buying a home, etc.

To measure outcomes, clear financial goals should be defined, with progress regularly assessed, including considering risk tolerance. Non-financial aspects such as peace of mind and financial education should be factored in, with regular reviews enabling adjustment in goals and strategy to ensure alignment with any life changes.

Ultimately, measuring investment outcomes is a comprehensive process that involves looking at an investor's investments in the context of their broader financial life and goals. It's about making sure that the financial strategy not only generates returns but also helps the investor live the life they envision.

5 key differences

As we have seen, the terms 'outcomes' and 'performance' are often used interchangeably in investing, but they refer to different concepts. Here's a breakdown of some of the differences:

Performance	Outcomes
Focus	
Measures the quantitative success of an investment based on its returns over a period of time.	Focus on qualitative personal results and whether an investment strategy aligns with and achieves an investor's personal financial goals.
Measurement	
Performance	**Outcome**
Is measured using metrics like returns, risk-adjusted return, and volatility, offering a snapshot of how the investment did in numerical terms.	Are measured based on the achievement of individual goals, such as retirement funding, wealth accumulation, or meeting other life milestones.
Time horizon	
Performance	**Outcomes**
Can be measured over any time frame (daily, monthly, annually, etc.), providing a historical look at investment returns.	Are evaluated over a longer-term horizon, often involving life goals and objectives, and can change over time depending on an individual's circumstances.
Relevance to the investor	
Performance	**Outcomes**
Is more relevant to measuring how well the investment strategy is working compared to historical results.	Are more relevant to the investor's overall satisfaction with their investment strategy, as they reflect how well the investments help meet personal financial aspirations.
Objective	
Performance	**Outcomes**
Seeks to optimise returns based on risk, efficiency, and market conditions.	Are about ensuring that the investor's financial strategy leads to the intended goals, such as funding future needs, retirement, or other specific objectives.

So what?

While performance and outcomes are distinct, they are inherently linked. Strong performance is typically a factor in achieving positive investment outcomes, but performance alone does not guarantee desired outcomes. It's essential to consider both in tandem when evaluating the success of an investment strategy.

An investment might perform well in terms of returns, but if it doesn't match the investor's risk tolerance or time horizon, the outcome could still fall short of expectations. For instance, a high-performing stock portfolio might yield substantial returns but might not meet the needs of an investor nearing retirement who requires stability and income generation.

Similarly, an investment that focuses on the investor's goals, such as a target-date fund tailored to retirement needs, might offer moderate performance but deliver the desired outcome of financial security and retirement readiness.

Investors should evaluate both performance and outcomes when making investment decisions, ensuring that their strategies align not just with benchmarks or historical returns but also with their long-term financial objectives. By doing so, they can make sure that their investments provide the best path to achieving their goals and securing their financial future.

Prioritise outcomes, but don't ignore performance. In the end, outcomes should be the primary focus for most investors, as they reflect the success of a strategy in achieving personal financial goals. While performance is an essential tool for measuring returns and assessing the effectiveness of an investment strategy, it should not overshadow the broader objectives that an investor is striving for.

Successful investing isn't just about chasing high returns; it's about ensuring that your investments are moving you toward your ultimate goals, whether that's a comfortable retirement, financial independence, or any other personal milestone. By balancing the pursuit of good performance with the focus on achieving meaningful outcomes, investors can create a strategy that is both effective and aligned with their financial aspirations.

On this day (www.onthisday.com)

19th December 1984	Chinese Premier Zhao Ziyang and British Prime Minister Margaret Thatcher sign the Sino-British Joint Declaration to transfer Hong Kong back to China in 1997
20th December 1955	Cardiff is proclaimed the capital city of Wales
21st December 1988	1988 Lockerbie disaster: A terrorist bomb destroys Pan Am Flight 103 mid-air, over Scotland; killing all 259 passengers and crew on board, and 11 people on the ground [
22nd December 1965	Great Britain sets national maximum road speed at 70 miles per hour
23rd December 1968	Frank Borman, Jim Lovell and William Anders become the first people to orbit the Moon aboard Apollo 8
24th December 1893	Henry Ford completes his first useful petrol / gasoline fuelled engine
25th December 1991	Mikhail Gorbachev formally resigns as President of USSR in a televised speech

Registered office:
Foster Denovo Limited, Ruxley House, 2 Hamm Moor Lane, Addlestone, Surrey, KT15 2SA.
Phone: 01932 870 720 Email: info@fosterdenovo.com Website: www.fosterdenovo.com | MB62231224