CHASING TRENDS, DOES IT REALLY WORK?

Somesh tracks the financial markets & various investment options closely. He works in an IT company and is a self-proclaimed investor. A few years ago he recognised a particular sector giving superlative returns and allocated a high percentage of his savings toward it. Unfortunately, it didn't do well next year. He identified another asset class and moved his money there. Again, the same thing happened. The investments did not do well. After a few years of shuffling investments, Somesh realised that his strategy was not working.

Let's find out why Somesh failed to generate any return at all.

Although Somesh did his homework before investing, there was a fundamental mistake made by him of 'chasing trends'. It is explained by behavioural finance where investors get lured by recency bias (looking at short term returns in the recent past) and enter at the top. Mostly, this strategy doesn't work and when the market trends reverse, the investment underperforms.

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Let's look at this with some real data points. Below is a chart of annual returns given by certain sectors/categories of investments over a period of 10 years.

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Mid Cap 44.28%	Debt 8.51%	Smallcap 62.95%	Midcap 8.41%	Gold 10.10%	Small Cap 57.30%	Gold 8.65%	Gold 21.89%	Gold 31.58%	Smallcap 59.28%
Small Cap 34.29%	Large Cap 6.76%	Mid Cap 60.26%	Debt 8.03%	Debt 7.41%	Midcap 47.26%	Debt 8.00%	Largecap 12.02%	Midcap 21.87%	Midcap 46.06%
Largecap 27.70%	Midcap -3.01%	Largecap 31.39%	Smallcap 3.81%	Midcap 4.83%	Largecap 28.65%	Largecap 3.15%	Debt 7.14%	Smallcap 21.47%	Largecap 24.12%
Gold 9.885	Gold -3.01%	Debt 8.90%	Largecap - 4.06%	Largecap 3.01%	Debt 6.96%	Midcap -15.42%	Midcap - 4.32%	Largecap 14.90%	Debt 6.37%
Debt 8.62%	Small Cap -0.64%	Gold -10.79%	Gold - 5.51%	Small Cap 2.39%	Gold 3.64%	Smallcap -29.08%	Smallcap -9.53%	Debt 6.23%	Gold - 4.02%

Source: Equity: Nifty Large cap, Mid cap, Small cap index. Debt: Quarterly average of G-Sec Yield. Gold- RBI

From the above chart, it is clear that sectors/asset classes perform in rotation. For example, Gold was the worst-performing asset in the year 2014 as well as in 2015 but it topped the return chart for the next 4 out of 5 years. Equity small cap was the top performer in the year 2014 but returns deteriorated and eventually it bottomed in 2016. It again bounced back as a top performer in the year 2017. There are several such examples in the above table.

MORAL OF THE STORY

Chasing recent returns may not be a good indicator of future returns. It is better to invest through a proper asset allocation strategy and stay invested for the long term.

* Mutual fund investments are subject to market risks, read all scheme related documents carefully before investing.
* Returns are not guaranteed. Assumption of returns are at portfolio level. It is not an indication of specific scheme returns. The above is for illustration purpose only.

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