December 2008

The Importance of Time Horizon

In his excellent book , "Winning the Losers Game", Charles Ellis states:

> *"Time – the length of time investments will be held and the period of time over which investment results will be measured and judged is the single most powerful factor in any investment program."*

If the time horizon is long, a wise investor can commit without great anxiety to investments that appear to be risky but that will most likely produce the highest long run rate of return.

As you can see from Table 1, 2 and 3 below, traditional and alternative asset classes have generated a premium above the return of cash across different time periods over the past 100 years (risk premium). In addition, we can see that generally, the riskier asset classes have generated higher risk premia leading us to the conclusion that risk is efficiently priced by the markets at the individual asset class level.

Table 1. Long Term Asset Class Performance – 1900 to 2007

GBP	Ann. Return	Ann. Return Above Cash	Ann. Volatility	Maximum Loss	Return / Vol
UK Equities	9.0%	4.4%	22.5%	-65.6%	0.40
UK Bonds	5.4%	0.8%	10.4%	-26.6%	0.52
UK Cash	4.6%		3.5%	NA	NA
UK Inflation (CPI)	3.2%		6.0%	NA	NA

Source: London Business School, Frontier Capital. Returns calculated using annual data.

Table 2. Medium Term Asset Class Performance – January 1973 to December 2008

GBP	Ann. Return	Ann. Return Above Cash	Ann. Volatility	Maximum Loss	Return / Vol
UK Equities	11.0%	2.7%	20.7%	-66.0%	0.53
UK Bonds	10.8%	2.4%	8.1%	-15.5%	1.34
UK Real Estate	8.7%	0.4%	21.0%	-75.3%	0.42
Commodities	11.8%	3.4%	20.0%	-52.2%	0.59
UK Cash	8.3%		1.9%	NA	NA
UK Inflation	4.5%		1.5%	NA	NA

Source: Bloomberg, Frontier. Returns use monthly data. Multi asset portfolios equally weighted and rebalanced annually.

Table 3. Short Term Asset Class Performance – January 1991 to December 2008

GBP	Ann. Return	Ann. Return Above Cash	Ann. Volatility	Maximum Loss	Return / Vol
Global Equities	7.4%	1.1%	13.8%	-44.3%	0.54
Global Bonds	9.3%	3.0%	3.3%	-4.7%	2.82
Emerging Equities	10.8%	4.4%	23.7%	-58.6%	0.46
Emerging Bonds	14.6%	8.3%	14.7%	-32.2%	0.99
Global Real Estate	9.1%	2.8%	13.9%	-58.3%	0.65
Commodities	5.1%	-1.3%	20.0%	-52.2%	0.25
Hedge Funds	8.4%	2.1%	6.2%	-20.8%	1.37
Managed Futures	10.6%	4.2%	9.5%	-9.1%	1.12
Multi Asset Portfolio	10.5%	4.2%	8.5%	-24.1%	1.25
UK Cash	6.3%		0.6%	NA	NA
UK Inflation	2.3%				

Source: Bloomberg, Frontier. Returns use monthly data. Multi asset portfolios equally weighted and rebalanced annually.

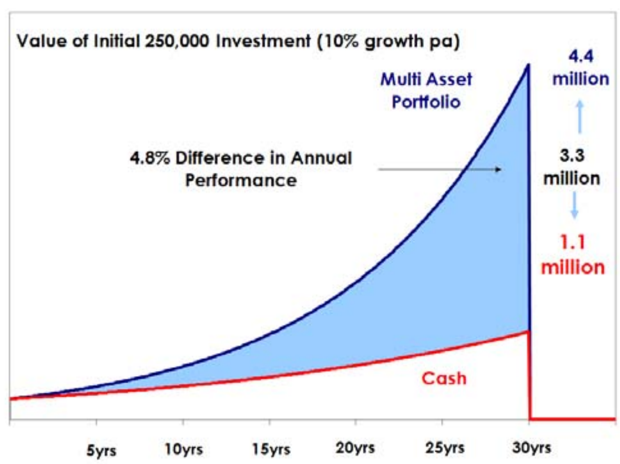
However, over shorter periods asset classes can also exhibit periods of acute loss, which we have experienced recently. Therefore, when investing in risky assets, a key consideration is the time horizon of the investment. The graphs below illustrate the rolling return over 1-year, 3-year, 5-year and 10-year holding periods for both a 4 asset and an 8 asset class portfolio. While 67% and 76% of one year rolling returns are above the return from cash, this rises to 92% and 94% over 5 years and 99% and 100% over 8 years. All 10-year holding periods have produced a return above cash with the lowest return for the eight asset class portfolio producing a 3.0% annualised return above cash, with an average of 4.8% annualised returns above cash. The compounding advantage of this over time can be seen in Graph 1 and reinforces the importance of considering the time horizon when making investment decisions.

Table 4: Multi Asset Class Portfolio Performance

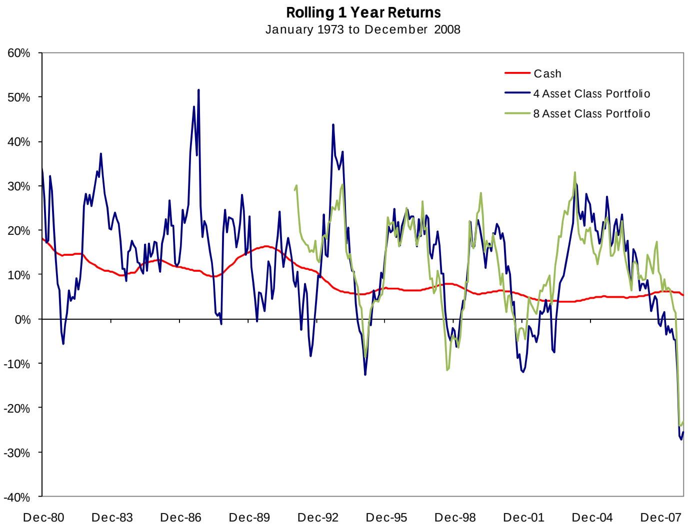
	4 ASSET CLASS PORTFOLIO Jan 73 to Dec 08	8 ASSET CLASS PORTFOLIO Jan 91 to Dec 08
Ann. Return	**12.4%**	**10.0%**
Ann. Volatility	11.0%	8.3%
Return / Volatility	1.1	1.2
1 Year Rolling % > Cash	67%	76%
3 Year Rolling % > Cash	83%	92%
5 Year Rolling % > Cash	92%	94%
8 Year Rolling % > Cash	99%	100%
10 Year Rolling % > Cash	100%	100%

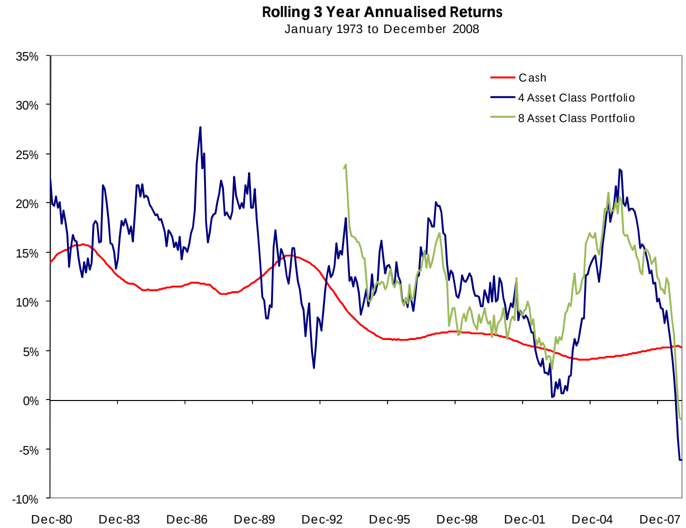
Source: Bloomberg; Frontier Capital Management.
Note: Returns for all eight asset classes are only available from January 1991.

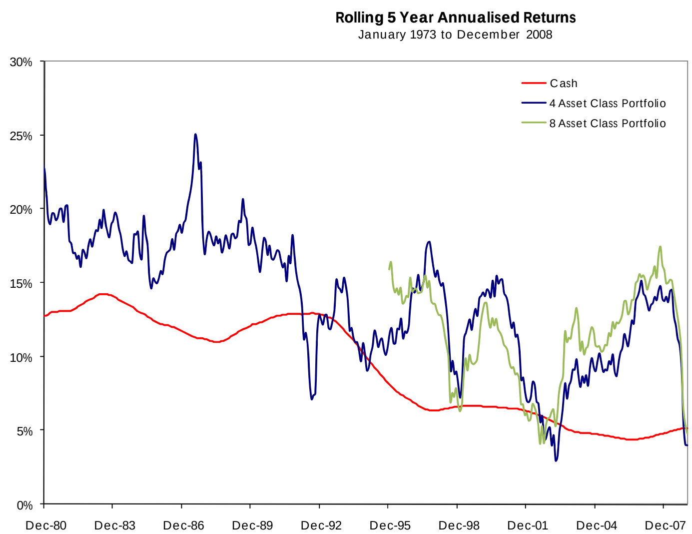
Graph 1: Cumulative Effects of Returns Above Cash

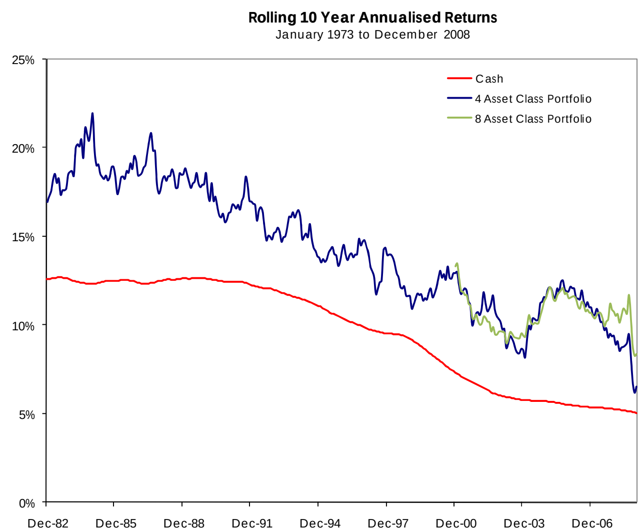


Graphs 2-5: Cash, 4 Asset and 8 Asset Class Portfolio Rolling Returns









Source: Bloomberg; Frontier Capital Management
Notes: The eight asset class portfolio is an annually rebalanced, equally weighted portfolio using the benchmark returns of Frontier's eight asset classes, with returns hedged into GBP where necessary. The four asset class portfolio is an annually rebalanced, equally weighted, UK centric portfolio consisting of Equities (FTSE All Share), Bonds (Citi 10yr Gilts), Real Estate (GPR UK All Property) and Commodities (GSCI). Returns have been hedged into GBP where necessary. No trading or rebalancing costs have been applied to either portfolio. Cash is UK 1 month Libor.

The Frontier MAP Funds are used by our investors to achieve medium to longer term investment objectives and the risk profiles of our funds have been designed with this in mind. The MAP Conservative fund is aimed at investors with a time horizon of approximately 5 years while the MAP Moderate fund is aimed at investors with a time horizon of approximately 10 years. For investors with a shorter time horizon, investments into the MAP Conservative Fund and a holding in cash would represent an optimal mix.

Summary

The investment time horizon is one of the most important factors to consider in any investment strategy. Investors with longer time horizons can afford to accept the higher volatility of "risky" asset classes, safe in the knowledge that they will be compensated with higher returns.

The Frontier philosophy and the MAP Funds have been built as medium to longer term investment "engines" that allow our investors to capture the embedded "risk premia" across multiple asset classes for a targeted level of risk. By accessing each asset class for very low cost, the majority of the returns are passed on to investors and the cost savings compound over time.

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