

<https://blog.en.erste-am.com/investment-horizon-phrase-or-mathematics/>

Investment horizon - phrase or mathematics?

Karin Uličná



© (c) APA-PictureDesk

If you search the term [investment horizon](#) in the Internet, you can find various definitions such as: „Investment horizon is the term used to describe the total length of time that an investor expects to hold a security or a portfolio “, or “The investment horizon designates how long an investor plans to hold its [portfolio](#) of securities to realize a profit based on the accepted risk “. However based on these definitions, is it clear what does Investment horizon exactly mean? Is it a time, after which the portfolio achieves certain expected return, or performance minimum 0%, or its value does not fall under the defined maximum loss? Investor can define his investment horizon when fulfilling the investment questionnaire and when doing this, he certainly expects that investing will bring him a profit. The definition of investment horizon is not exactly defined. Therefore this term could be understood differently.

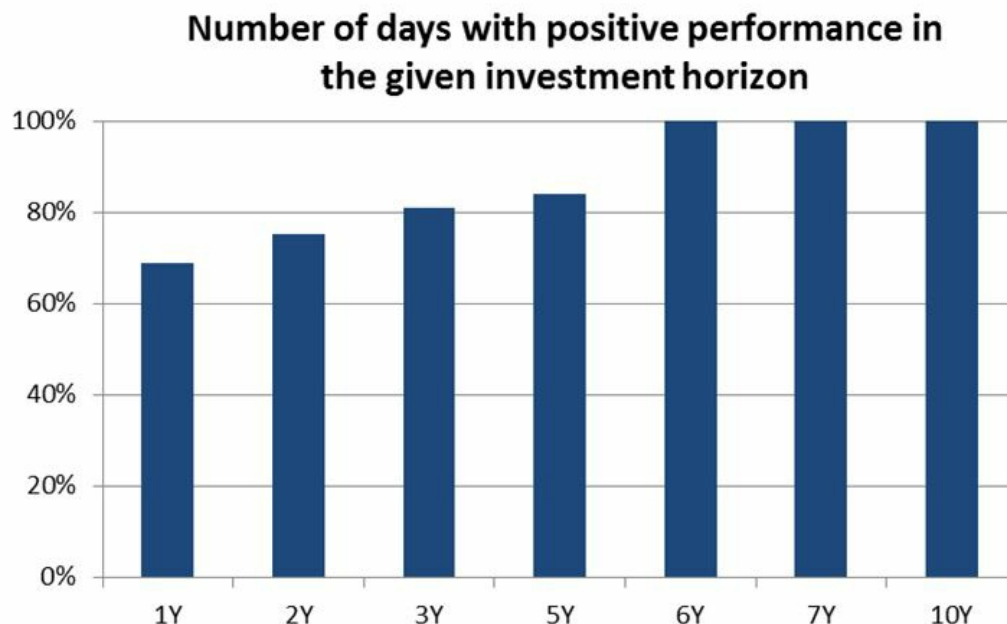
Mathematically the term investment horizon can be explained based on the value at risk approach. As an example I can use the real data of the fund with the medium level of risk, which average return for the last 5 years is 2% p.a. and volatility for this period is 3,5% p.a. These data are used for calculation of the expected figures for the future. In purpose of simplification I assume that observations are normally distributed. In chart 1 there are displayed the ranges of possible results in the respective years in the future with the probability of 90%. Expected return is the mean value of possible results. The highest dispersion we can observe in the first year of investing, as the time passes, ranges narrow and their limit values converge to the level of expected return. After the eighth year of investing the lower limit of range gets above zero, which can be interpreted in a way that with 95% probability the fund will achieve at least zero performance after eight years. The rest 5% probability includes the cases, when it is not possible to quantify the amount of possible loss. Usually this covers the turbulent times in markets, which are rather rare.



Note: Past performance is not indicative of future development.

Theoretical model shows that with the increasing time the probability of loss decreases and even after keeping the investment horizon it is not absolutely guaranteed that the fund will be in profit afterwards. So if market slumps, investor should consider carefully, whether he redeems immediately even though he has kept his investment horizon. The situation could be opposite, such as the portfolio achieves unusually high performance within shorter time than the recommended horizon. During investing the asset prices fluctuate and there are time slots with various positive or negative performances. Therefore the recommended investment horizon should not be understood as a fix time of holding the investment.

Let's go back in time. In chart 2 there is percentage proportion of days, when one-year up to ten-year performance was positive based on the historical fund data from 31.12.2009 till 24.4.2019. One-year performance was positive in 68% of all days. Within two-year performance 75% of days were positive. The percentage share of positive days gradually grew. From six-year and longer performance all days in the tracked periods were in plus. This proves that longer investment period (above 6 years) delivered positive result to all unit holders staying in fund.



Note: Past performance is not indicative of future development.

What was the real behavior of unit holders? Their average investment horizon was 5,2 years, median 5,7 years. This is in line with the recommended investment horizon, which is usually stated in materials, such as Key Investor Information Document, Sale prospectus, monthly fact sheet.

Conclusion:

Investment horizon is a quantity that describes the degree of risk of investment. Together with expected return and volatility this parameter completes risk/return profile of the fund/portfolio. Longer investment horizon indicates higher risk of investment. It is a rough length of time to hold the investment, not the exact date in the future to sell the investment. The advantage of investing in mutual funds in most cases is a daily liquidity, but sometimes it is better not to check the value of investment every day. Keeping of investment horizon is important. In bad times it is worth to consider one's decisions and rather extend the investment horizon.

Legal note:

Prognoses are no reliable indicator for future performance.

Legal disclaimer

This document is an advertisement. All data is sourced from ERSTE-SPARINVEST Kapitalanlagegesellschaft m.b.H., Erste Asset Management GmbH and ERSTE Immobilien Kapitalanlagegesellschaft m.b.H. unless indicated otherwise. Our languages of communication are German and English. The prospectus for UCITS (including any amendments) is published in Amtsblatt zur Wiener Zeitung in accordance with the provisions of the InvFG 2011 in the currently amended version. Information for Investors pursuant to § 21 AIFMG is prepared for the alternative investment funds (AIF) administered by ERSTE-SPARINVEST Kapitalanlagegesellschaft m.b.H., Erste Asset Management GmbH and for ERSTE Immobilien Kapitalanlagegesellschaft m.b.H. pursuant to the provisions of the AIFMG in connection with the InvFG 2011 and regarding ERSTE Immobilien Kapitalanlagegesellschaft m.b.H. published in Amtsblatt zur Wiener Zeitung or at the web site www.ersteimmobilien.at. The fund prospectus, Information for Investors pursuant to § 21 AIFMG and the key investor document/KID can be viewed in their latest versions at the web site www.erste-am.com or www.ersteimmobilien.at or obtained in their latest versions free of charge from the domicile of the management company and the domicile of the custodian bank. The exact date of the most recent publication of the fund prospectus, the languages in which the key investor document/KID is available, and any additional locations where the documents can be obtained can be viewed on the web site www.erste-am.com or www.ersteimmobilien.at. This document serves as additional information for our investors and is based on the knowledge of the staff responsible for preparing it at the time of preparation. Our analyses and conclusions are general in nature and do not take into account the individual needs of our investors in terms of earnings, taxation and risk appetite. Past performance is not a reliable indicator of the future performance of a fund.



Karin Uličná

CIO Erste Asset Management Slovakia