

Stock Investing for the Long Term

In the last monthly issue, we documented that a Rs 100,000 investment in the Pakistani stock market 30 years ago would have grown to about Rs 20 million by now. The same Rs 100,000 invested in Defense Saving Certificates (DSCs) then would have grown to Rs 5.4 million, and in a bank would have grown to about Rs 1 million. Due to inflation, a product or service that cost Rs 100,000 thirty years ago, would cost Rs 1 million today. Thus, bank deposits barely compensated for inflation during this period.

In the present issue, we examine whether this phenomenon of stocks outperforming other modes of investments would work for shorter time periods as well. We study the last three consecutive 10-year periods – FY 97-06 (last 10-years), FY 87-96 and FY 77-86. As can be seen in the chart below the stock market outperformed Defense Saving Certificates, bank deposits and inflation in each of these 10-year periods. The average stock market performance was stable around 19% per year in each of these 10-year periods. Defense Savings Certificates offered around a 14% per year return, whereas bank deposit rate averaged 8% per year versus an inflation rate of 8% per year. Rs 100,000 invested in the stock market at the beginning of any of these three 10-year periods would have grown to at least Rs 542,000 by the end of that period, versus Rs 323,000 in DSCs and Rs 181,000 in bank deposits.

The worst period for the stock market over the last 30 years has been the 1995-1998 period, where the stock market experienced a negative return in each of these 4

years. Of the remaining 26 years, there were only 2 years where the stock market experienced a negative return. This poor performance in the 1995-1998 period was an outcome of the country experiencing a very high debt to GDP ratio, and excessive government borrowing, which crowded out the private sector and took Pakistan close to a default. The economic sanctions resulting from the nuclear bomb blast further deteriorated the situation.

The historical evidence of the Pakistani stock market, in line with that of international stock markets, suggests that investors investing for the long-term, generally meaning over 5 years, should prefer stock investing to bank deposits and national savings schemes. This is typically the money individual investors save for their retirement, to build a house in a few years, to educate or marry their children. Provident / pension funds have a long investment horizon and should also have significant amounts (30% to 40%) of their funds invested in the stock market. The best way of investing in the stock market is via professionally managed mutual funds in order to benefit from professional management and diversification. I have seen trustees of provident / pension funds keeping all the money in bank deposits and saving schemes, and taking pride that they are doing their employees a favor. The downside of this policy is that when the employees retire, their pension money has not grown fast enough, and has not outpaced inflation, to offer them a decent standard of living following retirement. A balance has to be maintained between safety and growth of capital.

Returns and Future Value of Rs. 100,000 invested in consecutive 10-year periods

| | FY77-86 | | FY87-96 | | FY97-06 | | FY07-16 (F) | |
|----------------------|---------------------------------|-----------------------------|---------------------------------|-----------------------------|---------------------------------|-----------------------------|---------------------------------|-----------------------------|
| | 10 yr average Annualized Return | Future Value of Rs. 100,000 | 10 yr average Annualized Return | Future Value of Rs. 100,000 | 10 yr average Annualized Return | Future Value of Rs. 100,000 | 10 yr average Annualized Return | Future Value of Rs. 100,000 |
| Stock Market | 19.14% | 576,200 | 20.04% | 621,240 | 18.42% | 542,300 | - | - |
| DSCs | 12.44% | 323,000 | 15.86% | 435,850 | 14.46% | 385,950 | 10% | 259,354 |
| Bank Deposits | 8.92% | 235,000 | 8.69% | 230,000 | 6.12% | 181,122 | 10% | 259,354 |
| Inflation | 8.69% | 230,000 | 9.42% | 246,000 | 6.11% | 180,950 | - | - |