Anthony Hilton

Published: Evening Standard 23 October 2014

Updated: 12:17, 23 October 2014

Wealth management firm Brewin Dolphin published a paper yesterday that warned investors in the stock market not to panic because of the recent turmoil.

The message was that while they may be tempted to turn their investments into cash, that might well be a mistake.

Its thesis was based in large part on the fact that money on deposit earns next to nothing, even in a cash ISA, while that invested in UK shares should produce an income of between 3% and 4%. Capita, a firm that monitors dividend growth, expects the dividend yield on the market as a whole this year to be 3.9%.

That is OK as far as it goes but a far more useful paper was published last year by Barclays Wealth. Intriguingly, it was entitled Overcoming The Cost of Being Human.

It was written by Greg Davies of the behavioural economics team to try to explain why it was that investors generally got far less from the stock market than they should, and played to the point that investors seemed to get between 2% and 3% a year less than they could have done had they pursued a different strategy. This shortfall Davies's team called the behavioural gap.

They poured scorn on the conventional view of financial economics that investors seek to maximise risk-adjusted returns.

Instead, they produced the concept of anxiety-adjusted returns — investors want to get as much as they can without incurring so much stress they want to tear their hair out. In effect, the observation amounts to the fact that investors are emotional not rational — in other words, they are human.

Basically, the message was that you make money in the stock market by having a diversified portfolio of shares that you have the ability to hold for a long time.

What you don't want to do is be forced to sell at the wrong time because you need the cash for something else. But it is even more crucial not to be shaken out by short-term fluctuations soon after you have bought. Unfortunately, this sometimes requires nerves of steel, and too many investors fail the medical.

In this analysis, successful investing is almost entirely about coping with short-term uncertainty — and if you can, the rewards are virtually guaranteed. The most interesting chart in the document is an analysis of the annualised returns or performance of the MSCI world share index from 1970 to 2011.

What it shows is that no one who bought shares in that period of four decades would have shown a loss if they had held the shares for 12 years or more — no matter what combination of purchase and selling dates they chose.

It is interesting that this shows it does not really matter when you buy — obviously it helps to buy low but it is not vital. That dozen years was the worst case; buy cheap and the required holding period was significantly less.

But the people who got badly burned in contrast were those who could not stand the heat, and almost all the losses coincide with holding periods of less than five years. And the worst losses are incurred by people who buy just before a crash and sell in fear and desperation just after.

The real message is that everyone talks of the stock market being risky — and it is if you see it as a short-term home for your money. But if you look at it from a long-term perspective, the risk evaporates.