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Nominal and Real Returns

Published on: 3 February, 2020 | Author: Investment Team

Barclays has issued the Equity Gilt Study in one guise or another continuously since 1956, providing data and analysis on long-term asset returns in the UK dating back to 1899. This long data set provides a unique picture of how returns are affected by two simple factors over time:

1. Inflation
2. Reinvestment of cashflows

The illusion of money is a perverse thing. We all consider it in absolute terms, but in reality, our 'real' wealth is more important to preserving our buying power in the future.

The two tables below illustrate this point very clearly. The first shows the nominal and real value of £100 invested in equities and gilts in 1899, without income from dividends and coupons being reinvested, the second shows the same values with income reinvested annually. The impact of inflation on the first table's returns is clear to see, as is the impact of reinvested income on the second.

£100 invested in 1899, without income reinvested	Nominal	Real
Equities	£11,808	£160
Gilts	£57	£1

£100 invested in 1899, with income reinvested gross	Nominal	Real
Equities	£1,639,368	£22,239
Gilts	£31,459	£427

Source: Barclays Equity Gilt Study, 2019

These numbers are important to our investment approach at Tacit as humans tend to think in nominal numbers. A 10% rise feels better than a 5% rise and a 5% rise feels better than no rise at all. This is all well and good if inflation is low, but if inflation is running at 8% and 3% respectively in these scenarios, the real return achieved was actually identical. The human reaction to these numbers however is very different as we all know.

We know that the above data is for a very long time frame and most investors will consider this irrelevant to their own circumstances. The results however are just as valid for shorter time frames and do provide a simple reminder to us all;

real returns are vital and that a £ in income in our hand today is worth more than promises of growth in the future.

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