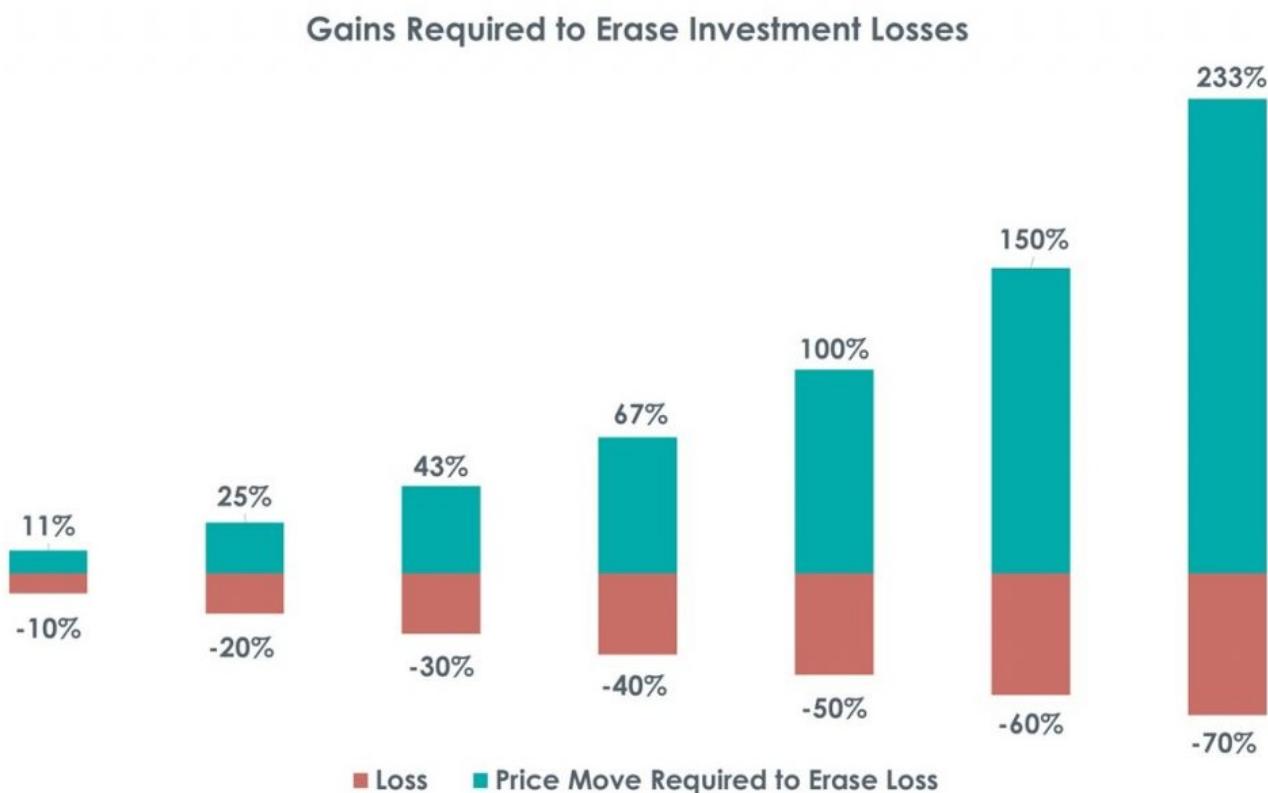


The Importance of Small Numbers

Published on: 5 April, 2019 | Author: Investment Team

At Tacit, we focus on limiting drawdowns. With the risk of sounding trite, maths shows us that a focus on minimising losses can increase returns.

How? Let's imagine you make a loss of 10% on an investment. In order to break even, you need to make back 11%. If you lose 40%, you need to make 67% to break even. If you lose 70%, you need to make back an astronomical return of 233% simply to get back where you started from. This is shown in the Figure below.



With every linear increase in the amount of money you lose, the amount of gain required to simply recoup the lost capital grows asymptotically to infinity. This is partly shown in the Figure above with the green bars (gains required to recoup losses) growing much faster than the red bars (losses). It is analogous to running a race where for every step forward you take two steps back. This is a losing strategy regardless of your level of conditioning or skill as a runner.

In investing, survival comes first and generating a return comes second. Survival comes from having a margin of safety – a gap between what an asset is intrinsically worth and its current market price.

Generating a return comes from either a closing of the gap between an asset's intrinsic worth and its market price or by a growth in its intrinsic worth. Currently, most of our equity holdings are in companies where there is a gap between their market prices and their intrinsic worth. To make a return, this value gap needs to close.

Imagine after careful analysis, you buy an asset that has an intrinsic worth of £1 for £0.80. If it takes 10 years for the value gap to close, you will make 5% a year which is just below the long-term return of the UK equity market. If the value gap closes in 5 years, you will make 8% a year. If the value gap closes in 3 years, you make a sizable 11% return a year.

Human nature naturally focuses on big numbers but in reality, investing is about understanding that small numbers can compound to provide very strong returns.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act 2000. Please note, tax and estate planning services are not regulated by the FCA.