HOLDING PERIODS OF EQUITIES

It is frequently stated that the "average holding period" of large capitalisation UK equities is of the order of one year or less. (Similar assertions are made about other classes of equities). This assertion is incorrect and it is important to understand why this fallacy arises as it leads to the incorrect assertion that shareholders, particularly institutional shareholders have a very short-term investment horizon.

In order to demonstrate the nature of the fallacy, consider the following hypothetical example. Assume that there are only two classes of investor, types A and B, in the market. Assume that investors of type A own 20% of the outstanding equity of all companies and hold shares for 20 years on average and that investors of type B own the remaining 80% of equities and hold shares for 3 months on average. Clearly the average holding period will be (0.2 X 20) + (0.8 X ¼) years….4.2 years.

Fallacious commentators, however, will observe that every year the total market experiences turnover of 20% of 5% plus 80% of 400% which is 321% from which they will wrongly deduce that the average holding period is less than 4 months as opposed to the correct figure of 4.2 years.

Is this similar to reality and does it matter?

Reality In fact a large proportion (in excess of 20%) of the UK large cap equity market is passively managed with an average holding period in excess of 10 years and an even larger proportion is either explicitly or implicitly managed on a core and satellite basis with very long holding periods. The balance of the market does turn over rapidly. This would suggest that the average holding period is rather long and certainly not less than 1 year. There are short-term investors in the stock market and there are long-term investors as well. They both have an important part to play in the provision of capital and in the maintenance of liquid markets.

Significance It is very important that policy decisions and media commentaries are made on the basis of fact and not derived from fallacious reasoning which is the basis of many assertions of "short-termism". For this reason UKSIP, as the representative of investment professionals, will not hesitate to clarify this point at every opportunity.

Footnote: In purely arithmetical terms the fallacy is based on the mistaken belief that the weighted average of the reciprocals of a set of numbers is equal to the reciprocal of the weighted average of these numbers.