Absolute Attainments vs. Relative Returns: Money Match of the Millennium.

As is true of many instances of investor loggerheads or uncertainty, there are two twinset concepts in play here: Risk and Reward, and Greed and Fear. Both lie at the core of almost all investment theories, outcomes, methodologies, styles, approaches, objectives, successes and failures, just as certainly as there is no smoke without fire.

In 1750 and before, when Lloyds of London was in a coffee-shop – the contemporary equivalent of Starbucks - and stocks and shares were just that: funded participation in shiploads of spices and silk stocked in the cargo-holds of those galleons which did or did not founder, or succumb to Barbary pirates returning from the orient – distribution and weight of capital available for investment amongst Englishmen was very different from now.

Even apart from the wealth of the Crown, 99% of available capital was in the pockets of 1% of the people. That 1% consisted, by and large, of people who had far more money than they needed; there was competition amongst the impecunious to lay hands on pennies alright, but there was not much competition to make financial returns perform in any particular way. Natural instinct amongst those whose wealth was not in land was to hide it under their mattresses for as long as it was not stolen by the others. There was no known inflation, and awareness of financial interest and lending rates was restricted to theoretical stories about Shylock and the moneylender stories in The Bible.

Against this richly embroidered tapestry of yesteryear's investment behaviour, it is little surprise that skills, needs and instincts developing over the centuries originally first gestated respect for relative returns: do I have more than my neighbour? Will I have more tomorrow than today? Will there be more silk to sell in tomorrow when my ship comes in than there was last time I funded an expedition to Ophir or Nineveh, Xanadu or Xanthippe? And who could blame them? Will my black tulips flower quicker than his – and will my investment ion the South Seas bubble earlier and larger - or later and lesser – than his.

This historical exegesis may well sound as though it's simpleton's stuff. It may well be that Galleons never plied the Thames, or that Xanthippe never provided spices – and neither matters. The core truism is that economic – and therefore investment – principles and practices are shaped by the economic and demographic circumstances of the day, rarely by flashes of inspiration or original thinking.

Pan in on the UK – and the world - 250 years on. During the intervening period, key pecuniary developments have been underway, notably (i) the spread of disposable wealth through all socio-economic tiers; (ii) the growth of capitalism and therefore of available capital; (iii) the 'commoditisation of money', and (iv) the trend towards consumption. These four factors interplay in such a way that relative wealth, relative increase in wealth – i.e. of investment performance – and of relative fortune or misfortune are no longer of prime interest to spenders, bankers or merchants.

Yes, there have been rollers and coasters (perhaps they are meant to remind one of those galleons plying the Red China sea in the storms which sank them) such as the eras of rampant inflation, of astronomic interest rates – remember 20% and more in the OK of the mid 70s? – Germany in the '20s? – Wall Street in the Great Depression? – it all makes trading with cowrie shells look a wonderful alternative. The point is that, despite erratic stages and exceptional events, behaviour of money became much of a muchness, and the behaviour of money-makers has followed suit, purely because commoditisation tends to be as great a universal leveller as was denim in its day, and, if the truth be told, it levels with a downward tilt more often than with the upward equivalent. See – knowingly or mindlessly – this through the eyes of a dedicated consumer, and the pricking of greed based on fashion, aspiration, accumulation and differentiation have inevitably played their part. The respect for relative wealth and relative performance has steadily given way – only significantly, it must be said, since the mid-20th century, to exploration with absolute returns, wealth and financial performance.

The stoutest milestone in this progression has been the evolution of the hedge fund. Their segment was born – in the US, in the mid 1970s – to those investors who felt the urge to abandon the monetary strait-jackets imposed on investors, money managers and spenders by lowish interest rates, lowish returns, lowish cost of money and by an exaggeration sense of risk-aversion, doubtless imposed by the experiences of a few hundred years of war worldwide. The UK caught on in the late '80s – 10 years after the US, as was always the case in financial innovation – but the reasons and results were the same. Absolute returns became the god; relatives went out of the window. Like the over-swings of all pendula, this veering fashion upset the staid positioning of indexation, benchmarking and tracking. This was, in turn, countered by an era of experimentation with synthetics, derivatives and comparable devices such as caps and cups, lock-ins, lock-outs, warrants, futures and options, all jostling to rebalance the *perpetua mobile* of greed and fear, risk and reward. The object was to perpetuate relative return as a respectable objective – not only to rescue the jobs of the boys, but also to harness what was already there and make it perform like a cleverer pony.

Of course, risk and reward, greed and fear have always prompted starry-eyed people to try and define, enslave and project them. To some extent, they have made advances with algebra and geometry, pencils and computers. The four twinset components respond to technical analysis and their devices and conventions, at least to some extent, but noone has been able to persuade anyone that they will go out of fashion. The implication of this against a background of shifting balances amongst preferences, weightings, products and practices as regards relative and absolute returns is to tell us two things. The first is that both are here to stay; the second is that the relationship between the two is still fickle and innovative, and will not come to rest for a few years yet.

This begs many questions of the usurper in the form of Absolute Returns: is he here to stay? How will providers of financial products cope? Who prefers this rather than the saggy comfort of relative returns? What patterns are being set up by demand, and where will it end up?

Unfortunately, as is so often the case, there is no definite answer to any of these questions. One can get bogged down in theory, projection, tales of extremes and in anecdotes based on millions lost and gained, all without getting any the wiser.

There is, however, an emergent core of reason and empirical demand to suggest that Relative Return will always be in demand, but (i) less so than before, and (ii) in more sophisticated forms. A revolver held at one's head might elicit the best guess that, by 2020 in the UK, 45% of funds under management will be dedicated to absolute return objectives and the balancing 55% to relative returns – and that the frontier between them will be blurred by synthetic balanced products, automatic switching devices between different 'silos', hybrid derivatives, stop-losses and automated re-balancing methodology.

Those who wonder why so high a level of relative returns will persist despite the attractions of absolutism need to look at an increasingly complex picture in the UK consisting of demographic change, greater longevity, higher expectations and protracted pensions chaos. This video picture is projected against an unchangeable screen depicting risks and hazards: terrorism, war, climate change, tsunamis, earthquakes, avian flu, market crashes.....you name it; it's there.

The only answer is to reach for a judicious balance between the two extreme of objectives. The pension fund trustee, as much as the punter on the make, will decide that putting a third at risk and two thirds safe will – to satisfy the curiosity of the simpleton – prove to be the balance which provides the best level of comfort.