

DISPATCHES

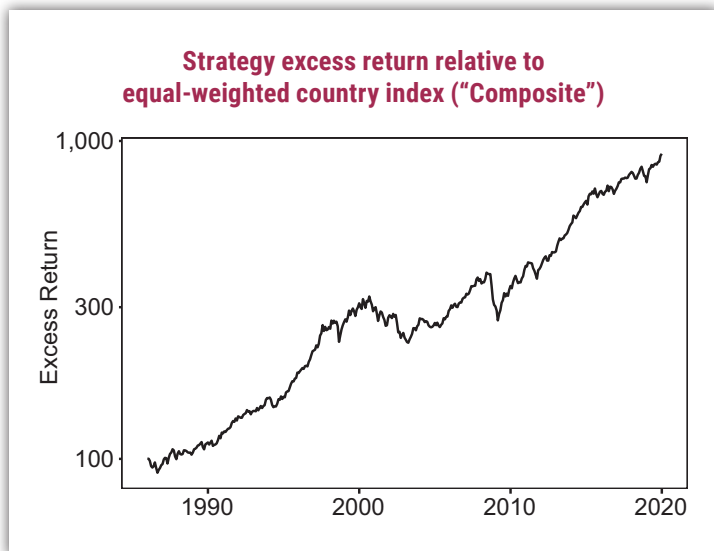
Backtests Reveal Strength of Buffett Indicator as a Long-Term Market Predictor

A study tested Warren Buffett's belief that looking at the value of the equity market relative to the gross domestic product (GDP) could be a good predictor of stock market mispricings.

Researchers analyzed Buffett's theory on international stock markets using the ratio of the market value of equity scaled by GDP, or MVE/GDP. The study covered 37 democratic countries with market-based economies, using quarterly data available for market capitalization and GDP starting in 1985. The researchers set up trading rules to backtest the MVE/GDP indicator in a practical environment and determine how the highest model-predicted returns performed compared to a buy-and-hold strategy. They used a 10-year horizon to forecast equity returns.

The study found that from 1985 to 2019, a composite average of 10 strategies returned 10.5%, on average, compared to the benchmark performance of 9.5% for the S&P 500 index. Additionally, the outperformance was accompanied by lower volatility (13.6% vs. 14.2%), a superior Sharpe ratio (0.57 vs. 0.49) and a reduction in maximum drawdown. The results also showed that the MVE/GDP ratio explains 83% of overall return variation, ranging from 42% for Austria to 94% for Great Britain.

The study results show that the MVE/GDP ratio possesses statistically significant forecast properties for long-term equity returns. The Buffett Indicator can thus be viewed as a yardstick for investor sentiment toward stock markets and, by logical extension, toward financial assets in general.



The analysis conducted in the study demonstrated that the market value of equity relative to GDP provides a useful tool for investors.

Source: "The Buffett Indicator: International Evidence," by Laurens Swinkels and Thomas S. Umlauf; SSRN, March 30, 2022. ■

401(k) Managed Accounts Are an Underutilized Resource

A study by Cerulli Associates outlines the value proposition of 401(k) managed accounts and their associated benefits for retirement plan participants.

The study, sponsored by Edelman Financial Engines, was conducted in the fourth quarter of 2023 using three focus groups and a survey of 823 working and active 401(k) plan participants. Focus group participants included managed account users, early career nonusers of managed accounts and late career nonusers. The weighted survey ensured that age, gender, total investable assets and retirement assets were diversified to better mirror the U.S. population.

Key findings include that a participant in a defined-contribution managed account program is nearly three times as likely to be very confident in their retirement investing strategy compared to those who have not used advice. Fifty percent of those surveyed ranked the ability to speak with a human adviser as one of the most valued components of financial advice solutions.

However, 70% of plan participants were unable to correctly define defined-contribution managed accounts, showing an extremely low level of knowledge. The study further found that only 8% of retirement plan participants used a defined-contribution managed account, while 38% were enrolled in their plan's default investment and 35% were self-directed.

Therefore, researchers concluded that better communication and positioning of defined-contribution managed accounts as an employee benefit versus an investment product could be the drivers for higher adoption rates. The human advice component must be emphasized, with important steps dispelling participant misconceptions to bridge the gap in utilization.

These findings emphasize the need for more focused educational efforts that can clearly outline the benefits of defined-contribution managed accounts. Properly positioning these accounts as an employee benefit should drive stronger adoption by retirement industry practice and spur improved financial well-being for 401(k) participants.

Source: "401(k) Managed Accounts: A Misunderstood Value Proposition," Cerulli Associates, May 16, 2024. ■