ALTERNATIVE THINKING

The Hidden Value of Streaky Returns in Stock Portfolios

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Return streams that can perform well or poorly for an extended period of time – so called streaky returns – are more difficult to stick with and comprehend. These additional complexities associated with streaky returns suggests they should be avoided, all else equal. But all else is not equal. The marketplace tends to compensate this additional complexity risk with a higher-than-normal risk-adjusted return, suggesting streaky returns should be embraced by investors.

This insight is confirmed using the most comprehensive long-short stock selection factor database from Jensen, Kelly, and Pedersen (2023): a portfolio of factors exhibiting "high streakiness" realize a long-run Sharpe ratio that is approximately double that of "low streakiness" factors.

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