

Enduring thoughts

The Magellan Paradox

History never repeats itself. Man always does.

Voltaire

Legendary investor Peter Lynch delivered extraordinary results at the Fidelity Magellan Fund between 1977 and 1990, generating roughly **29%** a year. Yet the average investor in the fund earned annual returns closer to **7%**¹.

Why don't these two numbers match? Like the secret to good comedy... it's all down to timing.

Many investors piled in after strong performance and headed for the exits during market declines. They locked in losses and missed the recoveries that drove the fund's long-term success. The portfolio performed brilliantly but investor behaviour diluted much of that success.

This contradiction is known as the Magellan Paradox. It captures a persistent truth about investing: strong fund performance does not guarantee strong outcomes for the people who own them.

Three ideas explain why.

Time-weighted and dollar-weighted returns

Funds typically report time-weighted returns, which measure the portfolio's performance stripped of cash flows. They reflect only the manager's decisions.

Investors experience something else. Money goes in and out, often in response to market swings. The relevant measure becomes the dollar-weighted return, effectively the internal rate of return on the investor's own capital. When people add money after gains and withdraw it after losses, their realised return will sit well below the headline number.

Morningstar studies² show this pattern repeatedly. Cash arrives late in rising markets and leaves early in falling ones. Investors capture only a slice of what the market provides.

Sequence-of-returns risk

Another complication is sequence risk. Two portfolios may produce the same long-term average return yet lead to very different outcomes depending on when gains and losses occur. This matters most when investors are withdrawing money.

Losses early in a withdrawal period are especially damaging. Capital is reduced just as money is being pulled out. Even if markets recover, less capital remains to benefit. Unlike the Magellan Paradox, sequence risk is not about poor behaviour. It comes from the clash between volatility and the timing of withdrawals.

The behaviour gap

A broader explanation sits under both ideas: the behaviour gap, highlighted in research from Dalbar³. It reflects familiar investor habits. People chase recent winners, sell in downturns and act on short-term noise. The result is predictable. Money flows into rising markets and out of falling ones.

Over time these decisions erode returns. Investors buy after prices rise and sell after they fall. Precisely the wrong way round for long-term success. The Magellan Paradox is merely the most vivid example.

The real risk

For investors the lesson is simple, if uncomfortable. Markets are volatile and returns uneven. But the greatest threat to long-term success is often behavioural rather than financial.

The history of the Magellan Fund shows that even the best strategy cannot help if investors mis-time their decisions.

Markets may be unpredictable. Investor behaviour, frequently, is not.



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Behaviours that derail strong performance

Performance chasing

Investors allocate after recent outperformance.

Loss aversion

Drawdowns trigger redemptions.

Recency bias

Recent returns are projected too far ahead.

Herding behaviour

Flows become a guide, process an afterthought.

¹ This widely reported figure is difficult to independently verify and comes from comments made by Peter Lynch

² Morningstar – Mind the Gap 2024

³ DALBAR – Quantitative Analysis of Investor Behavior (QAIB) 2025