INTUITION
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Taking a step back from the craziness

The last 12 months have accelerated some global trends in a manner seldom experienced since maybe electricity came onto the scene. The price action of some assets that have been clear winners in the circumstances has produced breath-taking accelerations. Where does that leave the average investor without the time or the appetite to chase the 'next big thing'?

Robin Gibson

I have talked often in both articles and presentations of how human beings are hard-wired to compare in their decision-making process. If you do not believe me then follow this link to see how retailers specifically [use our comparison bias to make us spend on their products.]

At the moment we are seeing several global events that are causing our "comparison meters" to absolutely redline, especially as it relates to our investments. Consider the chart below of investment returns since 1 March 2020:

Against these well-publicized returns, anything of a more pedestrian nature appears disappointing and downright unacceptable! If we are honest, we all get that feeling like we are missing out and should be doing something. Often

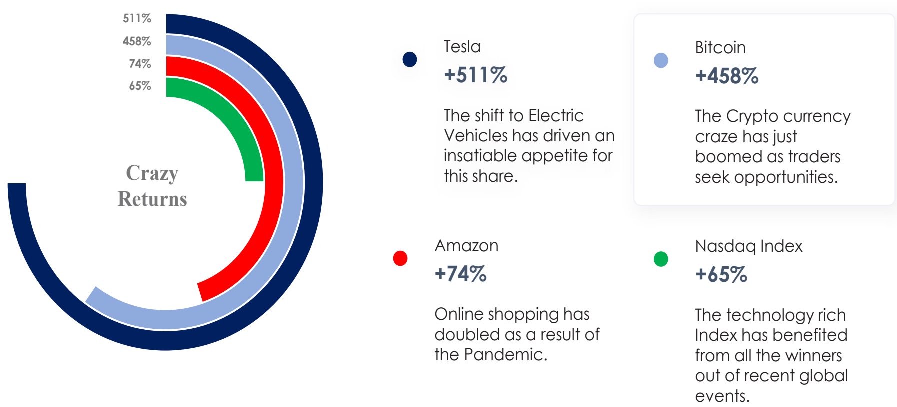
SPEED READ

- **South African investors are punch-drunk with local news flow on poor governance. This in the face of stellar American investment returns. It is a good time to take a step back and do some sober assessment.**
- **The last decade has not been nearly as bad as one might suppose. Compounding dividends has still worked well and if we go back to the start of the new century an investor can certainly justify holding his JSE assets.**
- **Diversification is a critical investment tool but chasing yesterday's winner is fraught with unnecessary danger. There is a greater chance of derailing your investment plan than there is of exceeding it.**

INVESTMENT RETURNS

Left Behind in the Rush

Price Change since 1 March 2020



There have been some eye-watering returns over the past 20 years, especially if one considers that the bulk of these returns have come in the last few years.

at times like these one should step back and re-evaluate one goals. What is a good investment return? What should I realistically expect from my investments? How should I feel about what I do not have in my portfolio? What should I be doing?

Well, first things first – timing markets is extremely difficult. No one has achieved it with any degree of accuracy. Secondly, the whole point of investing is to grow your wealth relative to inflation. If inflation were irrelevant, we could safely compound cash and interest in a bank account (although bank interest seldom really grows your wealth against inflation). So, what is reasonable? Well, history suggests that no matter what market you consider, a return of published inflation plus 4 to 6% in equity markets is reasonable and achievable. We would expect less from listed property (around 2% better than inflation).

So how have we done? We all know that South Africa has been disappointing over the last 5 years. Growth investments have not exceeded inflation and in the face of exceptional returns from offshore investments, locals have missed out. However, what about the 5 years before that? The JSE rose by just over 3% per annum over the 5 years to 2020. Published inflation over the same period was 4.35% p.a. However, in the 5 years to the end of 2015, the JSE All Share Index rose by 9.2% p.a. Inflation over that period was 5.3% p.a. This is much closer to our benchmark, but possibly still a little disappointing. Bear in mind however that these calculations were done on the absolute change in the index level and exclude any effect of compounding dividends. If we include the compounding of dividends then the 5 years to 2020 yields a return of 6.2% p.a. (inflation plus 1.84%) and the 5 years to 2015 yields a compound return of 12.3% p.a. or inflation plus 6.95% p.a, outside our upper expected band!

What if we analyzed the full ten-year period, often considered to be one of the worst on record with the full brunt of the Zuma legacy being felt? How does that weigh up relative to inflation? Excluding dividends, the JSE delivered an annualized return of 6.1%. This rises to 9.2% p.a when dividends are included. Inflation over the same period was 4.9% p.a. Therefore, if you consumed your dividends, your return exceeded inflation by only 1.2% p.a. However, if you compounded those dividends, your return exceeded inflation by 4.3% p.a. Right on expectation.

What are the takeaways from this exercise?

- Much as we would like returns to be linear (even returns relative to inflation) they never are. We have highlighted before that an investor who has been in the market for the last 20 years has only witnessed 9 years of exceptional returns (2004-2008 and 2012-2015). Yet over that period, the investor has experienced a compound annual return of 13.0% (dividends reinvested) versus published inflation of 5.23% p.a. – 7.77% better! (Furthermore, this period includes September 11, the Global Financial Crisis, the Covid-19 Meltdown, and all of South Africa's woes).
- To illustrate what this means in numerical terms, an investor who invested R250,000 as a lump sum at the beginning of 2001 would have R3.3 million today. But it would be equivalent to R1 million back then or 4 times the buying power. If they had chosen to invest R250 per month (rather than a lump sum) it would be worth R285,985 today - for a total investment of just R60,000.
- Compounding income is critical to long-term investment success. It is why we talk so much about the danger of higher costs. Higher costs imply that you must time your entry into, and exit from, an investment more accurately, as you are relying on the higher price change to provide more of the return. The risk of getting it wrong just once is enormous.
- Every year will bring outperformers offering juicy returns, in contrast to what your returns have been. The overwhelming temptation is to liquidate your current investments and transfer your funds there. Sometimes this can even happen for several consecutive years. Chasing yesterday's winners is a poor investment strategy in a long-term portfolio. You will undoubtedly win on some occasions (and heaven forbid that it happens the first time you try it, as that will create a dangerous deception of your investment skills), but again, it only has to devastate you once to leave you cynical and jaded towards growth investments and risk.
- We are hugely in favour of investing funds offshore. However, we highly discourage this based on historic returns rather than as an intentional diversification strategy. The last 10 years would suggest that South Africa, and consequently investing locally, is a spent force. There are certainly enough journalists repeating that narrative. What is interesting however is what the statistics tell us over 20 years. Had an American investor invested $1,000 in both the S&P 500 Index and JSE All Share Index in January 2001, the value of each (the SA investment converted to USD at the prevailing currency exchange) on the 31st December 2020 would have been $3,756 and $3,760 respectively. I would bet you wouldn't have expected that

What this tells us is that we should watch world affairs and exceptional markets and investments with interest. By all means take a small stake on the big performer, some bitcoin or other cryptocurrency. Remember, however, that a diversified portfolio has been the recommended approach for umpteen decades, not because it makes an asset manager's life easier, but rather because over the long term it works. Patience is necessary for investment success. It is not an optional extra.

Given the uncertainty over a second wave of Covid, we cannot predict with any certainty when we will be allowed to resume our seminars. Until we have clarity, we will continue with our online videos and presentations. Please ensure that you subscribe to our Facebook page and YouTube channel to be kept up to date.

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Topic: **N/A**

Natal Midlands

Date:	N/A
Venue:	Fernhill Hotel Midmar / Tweedie Road (almost opposite entrance to Midmar
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	N/A
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

CONTACT DETAILS:

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

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