INTUITION
9 DECEMBER 2022

Has my asset manager failed me?

This is a follow-on article from our 25th November 2022 Intuition where we explored a client's perceptions based on feelings and volatility in her portfolio relative to her other investments like cash. This issue of Intuition will delve further into behavioral finance, a growing discipline in psychology that examines investor mentality and biases. One of the worst things you can do to your investment portfolio is overdraw the income or access capital lump sums from it. Both events create a vicious cycle (the exact opposite of the virtuous cycle referred to as compounding) that can lead to calamitous long-term implications for your financial plan in retirement. What can often fool people is the way returns are reported. Harvard House statements reflect values taking portfolio withdrawals into account. Similar institutions report performance based on an Internal Rate of Return. In lay terms, they report performance only on the underlying assets held, not considering income drawn or capital withdrawals. This can often lead clients to believe that they would have been better off elsewhere.

Robin Gibson

We constantly remark that clients who think R1 million is a lot of money have not bought a sustainable, escalating income. It is probably one of the most expensive 'commodities' you will ever have to buy. Despite our regular warnings, they demand high income draws and raid their portfolios for capital needs (usually new cars or to help battling children.)* We cannot say no. After all, it is their money. Frequently, the die is cast when the portfolio is 'performing'. They somehow believe that Harvard House can protect them from any market histrionics and deliver double-digit returns when others are negative. This is not true, and it is the very reason for our income versus capital investment philosophy. The former is far more predictable and stable than the latter.

**This does not apply to every investor. Many clients draw incomes well within guidance and accessing the odd lump sum is not necessarily detrimental in these cases.*

From our perspective, however, portfolio performance is not about escalating market value. That is a secondary benefit from the primary goal. It is about sustainable, escalating income that exceeds inflation. When a client draws excessive income or a lump sum, we know that not only has the portfolio value decreased by the quantum of the withdrawal but so too has the income-producing capability of that capital. We see it as a double loss. For the investor, it plays out as a portfolio market value that never seems to climb which is exacerbated

SPEED READ

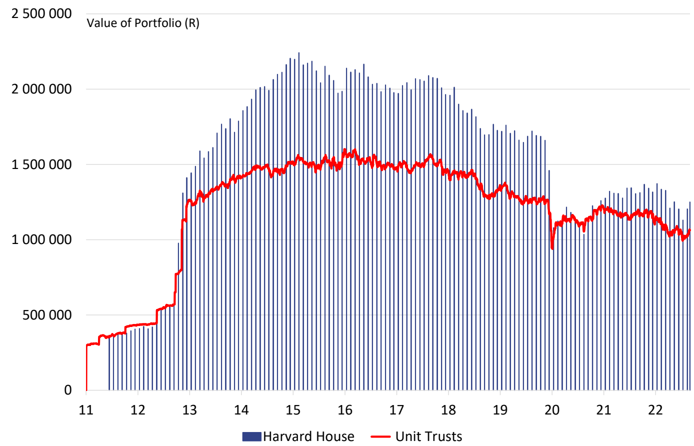
- **Harvard House has managed the retirement finances of hundreds of clients over the last 50 years. There is nothing more damaging to a marginal portfolio than exceeding the recommended income draw or raiding the portfolio for the odd lump sum.**
- **Investors mistakenly believe that a good asset manager protects them from every market crisis and that should that not be the case it is the asset manager's fault. This perception is aggravated if either of the two behaviours mentioned in the previous point are present.**
- **We regularly encounter investors who arrive with performance numbers from another investment fund. They perform a crude calculation on their portfolio and then suggest they would have been far better elsewhere. What they forget is that returns are not linear. Sometimes the performance is in the last three months, but they destroyed capital for the first nine months.**
- **Using our often-mentioned portfolio model where we track the performance of several of South Africa's biggest brand names, we demonstrate to an investor (who did ask us if he made a mistake investing with us, and who is overdrawing) that the blended equity-property approach has performed superbly relative to these peers despite the absolute decimation of the property sector during Covid**

by the volatility of the market value in difficult times.

What we often experience in these cases is that a client performs a rudimentary calculation on their portfolio. They take the latest value and the value from a year ago and calculate a percentage difference. (Harvard House reporting is amongst the most comprehensive and transparent in the industry, which at times can be disadvantageous to us, but remains a core value of the Group). Occasionally they will add the income back into the calculation, but not often. They will then approach us with the suggestion that their portfolio has underperformed compared to another fund or asset class. This happened very recently when a client who had recently had a sobering engagement on the state of their retirement finances approached me at a function to ask "Please be honest, did I make a mistake investing with Harvard House". The analysis that follows is based on this client's portfolio.

Our investor placed their first tranche with us in the first quarter of 2011. Full retirement came in late 2012, but the client continued with some contract work and only looked to draw more significantly on the portfolio in early 2016. His income requirement at this point represented 9% of the current market value, double our guideline income draw. He did drop this to 6% for 18 months but reverted to the higher income percentage from September 2019. The client invested a total of R1,336,000. The value peaked at just over R2,24 million in April 2015 and in late November (before the strong last week and early December Phala-Phala scare) was valued at R1,294,919. Over the period the client has drawn just over R1.1 million in monthly income. Had the client been invested in South Africa's 2 largest balanced funds quoted in our last article, his value today would be R1,062,282, almost R200,000 lower. The analysis is based

HH PORTFOLIO VS BALANCED UNIT TRUSTS



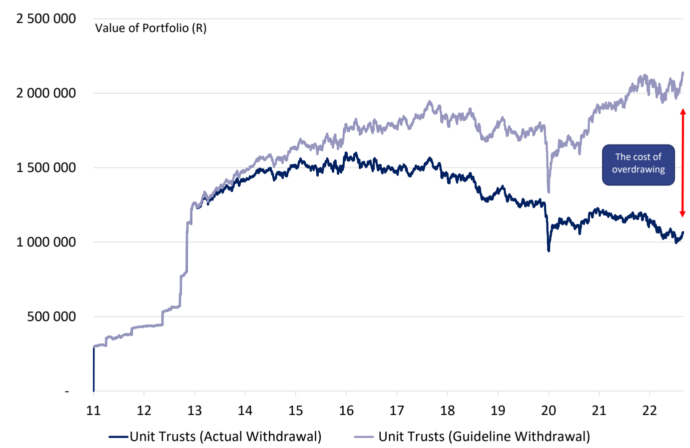
This chart plots the Harvard House month-end portfolio values versus the daily portfolio price if the client had been invested via an adviser on a platform into South Africa's two biggest unit trust funds.

on the same initial investment and withdrawals on the same dates (the comparison is reflected in chart 1).

Unfortunately, I cannot demonstrate what the value of the client's portfolio would have been with Harvard House had he worked within our recommended income draw, but I can demonstrate that with the unit trust portfolio. Given that I have already demonstrated that for equal conditions and income draws, the Harvard House portfolio comfortably outperformed the unit trust portfolio, we can expect that the Harvard House portfolio would have comfortably exceeded the equivalent exercise done on the unit trust portfolio.

Since the client initially invested a total of R1,336,000, we will perform our illustration on a starting income of 5% per annum or R5,500 per month. We will escalate this income by 10% per year – generous given that this probably exceeded inflation by more than 6% in some years. The comparison is reflected in the chart below. As we can see, the "new" portfolio value is more than R1 million greater than the actual portfolio and furthermore, trading at a new high. We could easily deduce therefore that the Harvard House portfolio, if operated identically, would comfortably exceed the 2015 high of R2.2 million. The Harvard House portfolio in our analysis is 17.7% higher than the unit trust portfolio – had the margin been the same, his portfolio would be approximately R2.5 million.

THE IMPACT OF OVERDRAWING



This chart uses the unit trust model to demonstrate the difference between the client's actual income draws and the Harvard House recommended 5% starting income with a 10% annual escalation."

Hopefully, this numerical illustration will demonstrate just how destructive it is to overdraw on your income. It is worth noting in this example that the client never took a lump sum. Maybe that's material for another week.

This will be the last issue of Intuition for 2022. We wish all our clients and readers a blessed and safe holiday season. We look forward to sharing more financial and market insight with you in 2023.

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INSIGHT 2023

Topic: **TBC**

Natal Midlands	
Date:	TBC
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

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

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

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