

Gamma trumps Alpha & Beta

Human Beings love acronyms. Every industry has its share of unique terminology that is almost like a language that new entrants must learn to communicate, or understand, their colleagues and peers. The investment community is no different. Beta is the term that measures the volatility of a share or portfolio relative to some index. Alpha is the excess return above the index's inherent move. Recently, a new term has emerged, called Gamma. This refers to the extra return gained by working with a professional financial planner.



**Robin
Gibson**

Investors today are obsessed with the relative performance of their funds. Alpha has become the only game in town. (In this context alpha refers to the return ahead of pure market index performance and, in this case, also to the return relative to all its competitors in the sector). Investors expect to be invested in the top-performing funds at all times. This expectation leads to very destructive behaviour

as investors' average period of investment in a portfolio sits at around just 3 years before they jump to the next alternative exciting fund that is realising the value of its positions built over the prior years. If cash or offshore funds or Bitcoin suddenly becomes the top performer then, like lemmings, people become unsettled and want to rush off in a new direction. Investors find it impossible to believe that truth that successful portfolios go through more periods of disappointment than exciting outperformance.

This is where Gamma, or the outperformance gained by partnering with a professional financial advisor, comes into play (and by this, we are not referring to a salesman looking to meet his monthly budget, but a truly partnering adviser who is working with you towards a set of specific objectives). If a financial advisor can plan a strategy and demonstrate the achievement of a goal with reasonable return assumptions, then by sticking with the plan an investor would have to do something monumentally wrong to fail.

I was sitting in a coffee shop last week and couldn't help but overhear the conversation of the 4 ladies at the table next to me. (I assumed that they were all widows and well into their seventies). They were each indignantly relaying

SPEED READ

- **Gamma is a term for the measure of added return that investors enjoy by engaging with a professional financial planner.**
- **The role of the financial planner is not to source the best return in the marketplace, but rather to implement strategies and warn against behaviours that may derail the ultimate outcome.**
- **We use an example to demonstrate that an investor with the right strategy, but invested in one of the country's oldest unit trust funds with 4th quartile performance (bottom 25%) would still have achieved their long term expectations.**

the conversation they had been having with their financial advisers who were clearly warning them about excess drawing from their investments. Rather than acknowledging their advisers' care and concern for their financial wellbeing, they somehow believed he was a secret agent acting on behalf of their children to optimise their inheritance! This is destructive behaviour. It ultimately leads to the belief that superior performance is the only solution.

We have on many occasions (and this is echoed in our "Understanding the Harvard House Approach" promotional document) highlighted that a growth-orientated portfolio of shares should expect a long-term return of 4 to 6% per annum better than inflation. Sadly, this never comes linearly. There are long periods where portfolios barely meet inflation (like the last decade or so on the JSE) and other periods where they handsomely exceed this range (such as the period between 2004 and 2010). In the end, the long-term investor enjoyed exactly the expected return above inflation despite crashes or disappointing periods.

So let us consider a hypothetical investor engaging with an adviser in mid-2001. His goal is to balance his shortfall on his pension fund, which at the time the adviser calculates to be a value of R700,000 adjusted for inflation. With just 20 years left and with all his surplus saving in cash the adviser warns the client that he needs to take some risk if he is going to meet this goal and that he cannot afford to stay in the safety of cash. Remaining in cash would mean he will need to save significantly more than he is currently.

Eventually, the adviser manages to convince the client that at 4 to 6% better than inflation, an initial investment of R50,000 and a monthly contribution of R500 invested into a growth unit trust should yield between R636,000 and R883,000 if inflation averages 5% per annum and the return range of 4% to 6% better than inflation is achieved. The planner places the investment in one of South Africa's oldest and biggest unit trust growth funds (started in 1970). After 5 years (the year 2006), his investment has grown to just short of R185,000 for a total investment of R79,500. The client is very pleased and thinks his adviser to be a wonder-worker. After another 5 years (the year 2011) with a total of R109,500 invested, the total value is around R290,500. The client was thrilled, the investment was growing exponentially, and yet the client was probably unaware that the unit trust he was invested in ranked around 67 out of 71 funds with at least 6 years of history!

By 2016 (15 years into the investment) the client had invested a total of R139,500 and his fund had swelled to an impressive R636,000, yet the ranking tables indicate that his fund manager was far from exciting, ranking 48 out of 76 funds over the last 10 years and 113 out of 167 funds over the last 2 years. Furthermore, the average annual return for the investment was below the equivalent cash return of 6.5% per annum.

The performance of the Fund deteriorated and in the final 5 years finished 107 out of 113 funds in the sector. It delivered a return of minus 0.2% per annum over that last five-year period. The Fund did enjoy a recovery in the last year of just over 19% which was a stronger finish to the 20 year period.

Throughout this investment, the adviser had to walk the client through the GFC (Global Financial Crisis) in 2008/09 when the client panicked, having seen his portfolio peak at R298,000 in May 2008, only to collapse to a low of R154,311 nine months later - a fall of 48%! It took 3 years to recoup that value.

In hindsight, the client could have bought Bitcoin, or exported his capital internationally and bought an offshore fund, or even possibly have moved to cash over the last

CLIENT INVESTMENT HISTORY



The chart tracks the value of the client's investment over the 20 years ending 30 June 2021. Despite severe investment challenges, and being invested in a relatively poor performer, the client still achieved their goals set 20 years before.

5 years and done better, assuming he timed it just right. In hindsight, there was probably a myriad of options. However, the bigger question should be, "Did he achieve his goals?"

According to Statistics SA, CPI inflation averaged 5.27% p.a from July 2001 to June 2021. This means that according to the initial planning done with the adviser he should have earned between 9.27% p.a and 11.27% p.a. This would have represented a range in his final investment value of between R665,298 and R924,111 based on his initial investment of R50,000 plus a monthly contribution of R500. What was his actual end value? R858,803 - a return of inflation plus 5.56% p.a. (Incidentally, we also ran this example through our internal model that tracks the country's top award-winning multi-asset high equity Fund and the client would have only achieved R30,000 more.)

This example highlights some valuable points, and are worth remembering:

- Long-term investing is a marathon where there are periods at which you could be behind your ideal checkpoint values.
- Compounding dividends at low purchase prices makes for a better return in the next up-cycle.
- There will always be a better return out there, but distraction and envy lead to destructive behaviour.
- Your financial consultant is not telling you to be patient for any other reason than the evidence proves over every 20 years of data examined, that sticking at it through the difficult times offers better rewards than jumping into last year's top-performing asset class.
- Research demonstrates that Gamma (the extra return by teaming with a professional adviser) is positive, demonstrating the value of partnering.



Please note, due to the concerns over the 3rd wave of Covid, Harvard House has decided to cancel our Insight presentations until further notice.



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Topic: n/a

Natal Midlands

Date:	TBC
Venue:	Fernhill Hotel Midmar / Tweedie 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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