INTUITION
26 MARCH 2021

Is the first impression always right?

Alchemy was the rage back in Medieval times. At its very heart, or so the legend goes, was the pursuit of turning other substances into gold. If an individual had got that right back then, he would soon have been a very wealthy man. Come to think of it, the same would apply today.

Robin Gibson

While we would likely laugh today at most of those alchemists from medieval times the truth is that the practice continues today in another guise. It is called the pursuit of superior investment returns. Just today, I had a phone call with a longstanding client who is rather ambivalent on the detail of their investments, but they didn't take long to start trotting out the 'flavours of the day' – Bitcoin, Gold, and mining. Everyone is looking to squeeze that little bit of extra return out of their investment portfolio.

We live in the information age. It is far more accessible to us than ever before and the worldwide web has made turned the planet into a small village. Investment returns have been published widely and the public is empowered to make comparisons (a bias we have explored on many occasions). This is how we see it most often play out:

Client Value	1 March 2020	R 373,050
Closing Value	28 February 2021	R 162,909
Percentage Change		-56%

The average performance of the Multi-Asset High Equity (what we have traditionally called a Balanced Fund) over the same period is 15.75%. The client is also bombarded with reports of the exceptional winners that have exceeded 100% over the last year (and in some cases 5 times that!)

> "Investment returns have been published widely and the public is empowered to make comparisons "

There is no doubt that the client wants to act, given his perception of the "unacceptable variation" between his returns and those of the average fund. However, is everything as it seems? Certainly not! The client had drawn an income of R15,000 per month, or R180,000 over the year. Amazingly, the underlying portfolio returned +11% after costs, not -56% as per the simple calculation based on opening and closing values. It was the client's income draw that created the negative perception. Furthermore, when he saw all the other investment returns published, he couldn't separate the numbers quoted from his circumstances. I am sure that you would agree that this is an easy mistake to make for a non-numbers person.

The above example may seem extreme and perverse, and you may think this is an extreme income relative to the starting capital (which it surely is) but believe it or not, this is an actual client example. Would you believe, however, that we received a complaint from the client's financial adviser (we only manage a portion

SPEED READ

- Most investors think that the single most important aspect of their investment is the published return of the investment portfolio. This can prove to be a red herring.
- Almost all investment houses publish their returns without any cashflows like fees or withdrawals applied to their portfolio.
- Investors typically compare published returns against a simple mathematical change in their portfolio value and think they are comparing apples with apples.
- Withdrawals can be more destructive than poor performance, and the actual withdrawals (of any description) from a portfolio can overwhelm even the best of returns.
- Our new statements have been designed to eliminate erroneous perceptions.

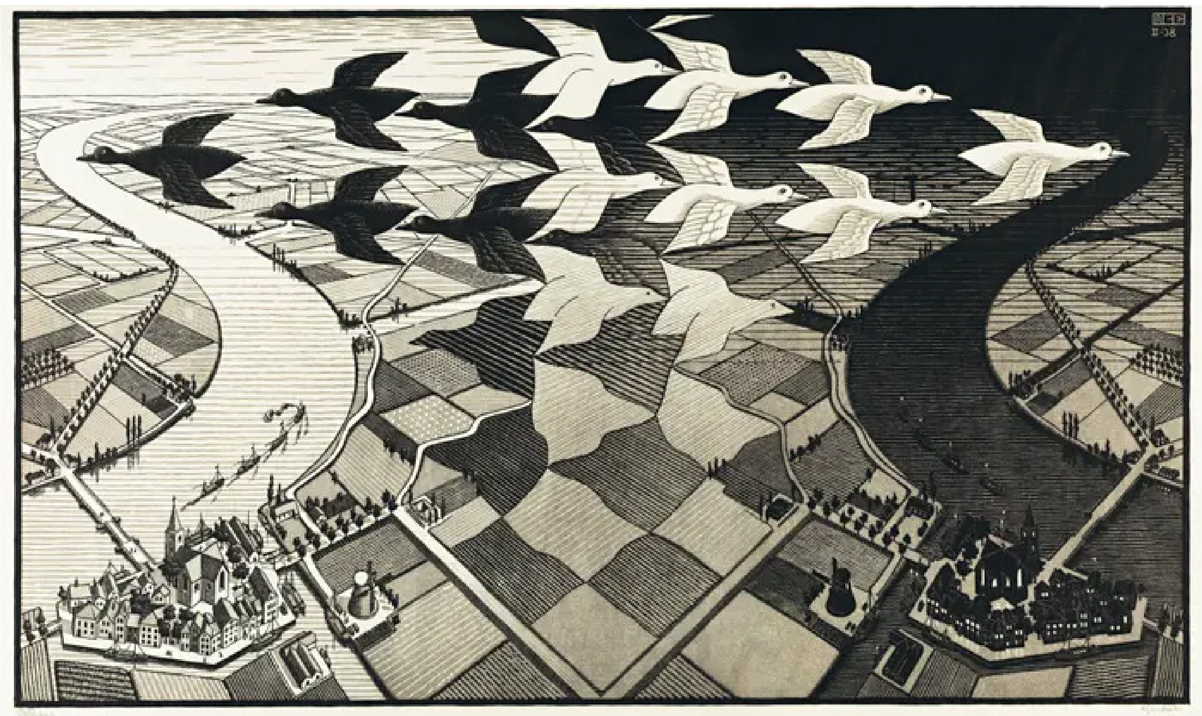
of the client's wealth) - a man who purports to understand numbers and compounding and is advising clients on their investments!

Clients will have noticed that we have changed our statements and have removed the 12-month analysis previously contained on page 2. We have received multiple compliments on our new statements and largely our client base has expressed satisfaction with the new format. There have however been a few clients who have expressed disappointment at the new structure and the removal of that 12-month. In some cases, clients feel we are trying to hide something. This couldn't be further from the truth. Our statements contain all the same detail as before and any client who wishes to run a similar analysis could easily set it up on an excel spreadsheet and populate the new data every month.

There are several reasons we have pursued the new format, all aligned with our investment philosophy:

1. The example above illustrates how even financially literate people interpret the 12-month analysis, often to the detriment of their long-term goals - as they make decisions based on erroneous perceptions.
2. By far the bulk of our clients are investing with us to manage a wealth pool that is required to provide retirement income. Retirement is a long-term game, even 85-year-olds need to plan should they live into their late 90's (it happens more often than you think). Our overwhelming experience was that the summary was turning our clients into 12-month thinkers which is extremely counterproductive when you are trying to focus on a long-term objective.
3. Every successful long-term investor suffers bouts of severe underperformance when some other investment appears significantly more attractive. We have enough historic examples in our own office to demonstrate this. It is a normal part of investing. Part of our role is to partner with clients to achieve their objectives. If we are providing the very thing that destroys this, we would be being poor partners if we didn't adjust our approach.
4. Our investment philosophy has always been about creating growing income streams, not pursuing the highest capital change from year to year. This, by very definition, implies that we are not going to pursue high-performing, non-income-producing assets with significant risk. Our new statements are far more focused on the income trajectory than before, which aligns with our investment philosophy.

We have seen how numbers can easily confuse and confound us. We live in an era where voices are loud and insistent and they attack us from every angle, imploring us to act. This cacophony adds to the stress that we are already experiencing by living through the strangest of times. Whoever would have thought that 'lockdown' would become a daily word. It is important in times like this to step back, stop and consider things beyond just the surface because not everything is quite as it seems.



The Dutch artist, Maurits Cornelis Escher, drew dozens of now-famous images to show how our brains battle with perception.

We are excited to announce the resumption of our seminar program in April. Please save the date below. Details for Johannesburg will follow soon. Please note that due to Covid protocols, numbers are strictly limited to 100 per session, and only drinks (no food) will be served. Booking is therefore essential.

Please RSVP to Clare Mitchell on 033 3302164 or clarem@hhgroup.co.za.

Harvard House is on Facebook

Harvard House is on YouTube

Topic: **Exiting the Covid Recession**

Natal Midlands	
Date:	Wed 21st April
Venue:	To be confirmed
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	To be confirmed
Venue:	To be confirmed
Time:	to beconfirmed

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:

HARVARD HOUSE GROUP

3 Harvard Street, Howick, 3290, South Africa

P.O. Box 235, Howick, 3290, South Africa

+27 (0) 33 330 2164

+27 (0) 33 330 2617

@ admin@hhgroup.co.za

W www.hhgroup.co.za