INTUITION
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Have investors lost sight of reasonable expectations?

Disappointment can be defined as the difference between expectation and reality. It follows logically that the greater the difference between expectation and reality, the greater the disappointment. This is the true realm of the Financial Planner. His role is not to seek the greatest return but to assist individuals in managing expectations in the face of reality. What makes this job even harder is that clients' expectations never stay static and they are generally influenced by the current context. This is where emotions generally impact investors' psyche.

SPEED READ

- **Many investors are disappointed with the recent behaviour of their portfolios.**
- **In the face of disappointment, we often lose sight of what our initial expectations were. Investment is not a 3 or 4-year exercise, it is 20 years or longer.**
- **A closer evaluation shows that despite recent challenges, the 20-year results of Equity and Property portfolios have exceeded expectations.**

Robin Gibson

Anyone that has spent any length of time with me will know that I often say that our job is to continually bring context. To help investors observe a much bigger picture rather than a very isolated set of circumstances. In this article, I will illustrate this idea by using an example.

The last 10 years in South Africa have provided plenty of opportunity for disappointment. Guptagate, State Capture, Jacob Zuma, Steinhoff, Load Shedding, Ratings Downgrade. It seems the list is endless. South African equities have not even beaten a very low inflation rate over the last 5 years. At the same time, we have seen the American Market soar on super-tech shares. Bitcoin faltered then subsequently turn stratospheric. It is easy in that context to believe that the JSE is a spent force.

How have the last 20 years turned out given that the last 10 years (50% of the period) were nothing short of awful? Has a high equity, low-cost investment strategy finally faltered behind a good conservative balanced portfolio with a high exposure towards bonds and cash? Before we answer that, let's return to expectations again. What was a reasonable expectation for a long-term investor 20 years ago? We think a pure growth investor should expect a return above inflation (CPI = Consumer Price inflation) in the range of 4% to 6% per year. Our expectation for an income profiled portfolio (60% Equity, 40% Listed Property and a 4% income yield) would be a return of 3,2% to 4,4% above inflation.

There is another way to understand this which may be easier. Study the table below. If I invested the sum of R500,000 twenty years ago, and assumed an inflation rate of 6% p.a, then I should expect my value today to be that shown in the 3rd column. However, using those values, and adjusting for the excess return you should have earned from investing in equities and property (shown in column 2),

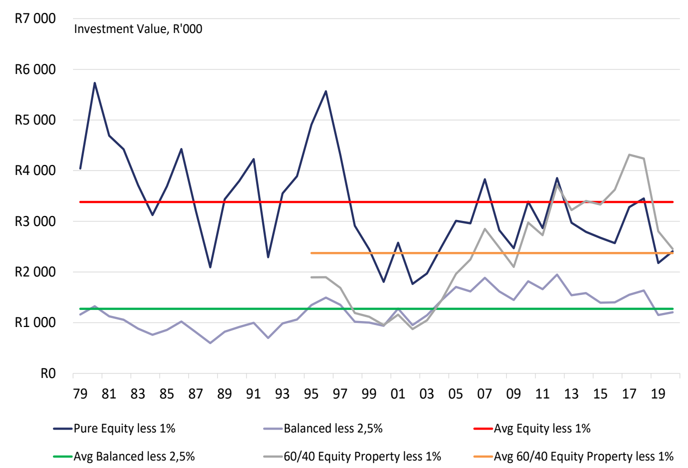
Investment Methodology	Rate above Inflation (CPI)	Expected Nominal Future Value	Expected Future Value (in current terms i.e. inflation-adjusted)
Property/Equity Blend (equities exceed CPI by 4%)	3.2%	R 3,126,253	R 947,433
Pure Equity Portfolio (equities exceed CPI by 4%)	4.0%	R 3,664,036	R 1,111,291
Property/Equity Blend (equities exceed CPI by 4%)	4.4%	R 3,966,528	R 1,203,000
Pure Equity (equities exceed CPI by 6%)	6.0%	R 5,446,276	R 1,655,100

Investment Methodology	Expectation Range (Actual Value)	Actual 2020 End Value	Equivalent Purchasing Value @ 2000 Prices
40% Property/ 60% Equity Blend (Portfolio cost at 1%)	R 3.1 – R 4 million	R 6,749,490	R 2,269,498
100% Equity (Portfolio Cost 1%)	R 3.7 – R 5.5 million	R 6,625,868	R 2,227,931
60% Equity/30% Bonds/10% Cash (Portfolio Cost 2.5%)	No projection	R 3,432,603	R 1,205,164

the last column shows your actual purchasing power (calculated back to 2000) relative to the R500,000 initially invested. In other words, the last column removes the impact of inflation to help clients understand the impact on your real wealth. In the example shown in the first line, an portfolio of equities and property that exceeded inflation by 3.2% p.a would have resulted in a near doubling of your purchasing power relative to your initial investment oof R500,000. The more aggressive the investment portfolio, the greater the growth in your real wealth.

So in reality, the above-right table reflects reasonable investor expectations over 20 years. Now let us revert to the actual position for the last 20 years. What would the position be if an investor had placed R500,000 in our market 20 years ago, based on several comparative methodologies? The following table provides the answer. (As a matter of interest South African CPI averaged 5.6% per annum for the 20 years ended 2020).

LONG TERM INVESTMENT RETURNS



The chart plots every inflation-adjusted future value of an investment of R500,000 into 3 different investment methodologies as explained in this article as well as the average expectation of all 20 year periods.

The Property/Equity Blend outperformed the Pure Equity portfolio as a result of the exceptional performance of Listed Property over the last 20 years and despite the collapse of the property sector that started two years ago and accelerated during the pandemic.

There is no doubt that a 20-year investment reviewed at the end of 2017 or 2018 would have looked substantially better relative to the assessment at the end of 2020, as highlighted in the graph that illustrates rolling 20-year returns of an R500,000 investment adjusting for inflation over each period. Nonetheless, investors will still have exceeded reasonable expectations that could have been made in respect of returns in 2000 when they originally placed the investments. Of course, it doesn't necessarily feel that way. What is most fascinating is that the period ending in December 2000 was probably the worst 20-year investment period of the 41 different 20-year periods we have analysed with our data. This may have made investors reluctant to stay in the market, or even make an initial investment. Yet the next 20 years still delivered ahead of the long-term expectation for either equity portfolios or blended portfolios of equity and property.

In summary, investors may be disappointed on many levels. They may even have felt that they have missed the opportunity to strike it rich through investments in Bitcoin, Tesla or Amazon. These feelings are completely understandable given what science has established about our reactions to events in the relatively new science of Behavioural Economics. Nonetheless, investors who have held tight for the last 20 years have exceeded their goals and we remain confident that the investor who remains committed for the next 20 will continue to do so!

Sometimes a few investment years, like Ancient Greece's Atlas, hold up the world (of investment).

We are excited to have resumed our seminar program in April in the Midlands (with the Johannesburg event to follow this week.) Our next seminar is scheduled for June / July. The topic will be announced in due course.

Please save the date below. 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.

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Topic: **To be advised**

Natal Midlands	
Date:	24th June 2021
Venue:	Fernhill Hotel Midmar / Tweedie Road Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	08 July 2021
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

CONTACT DETAILS:

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