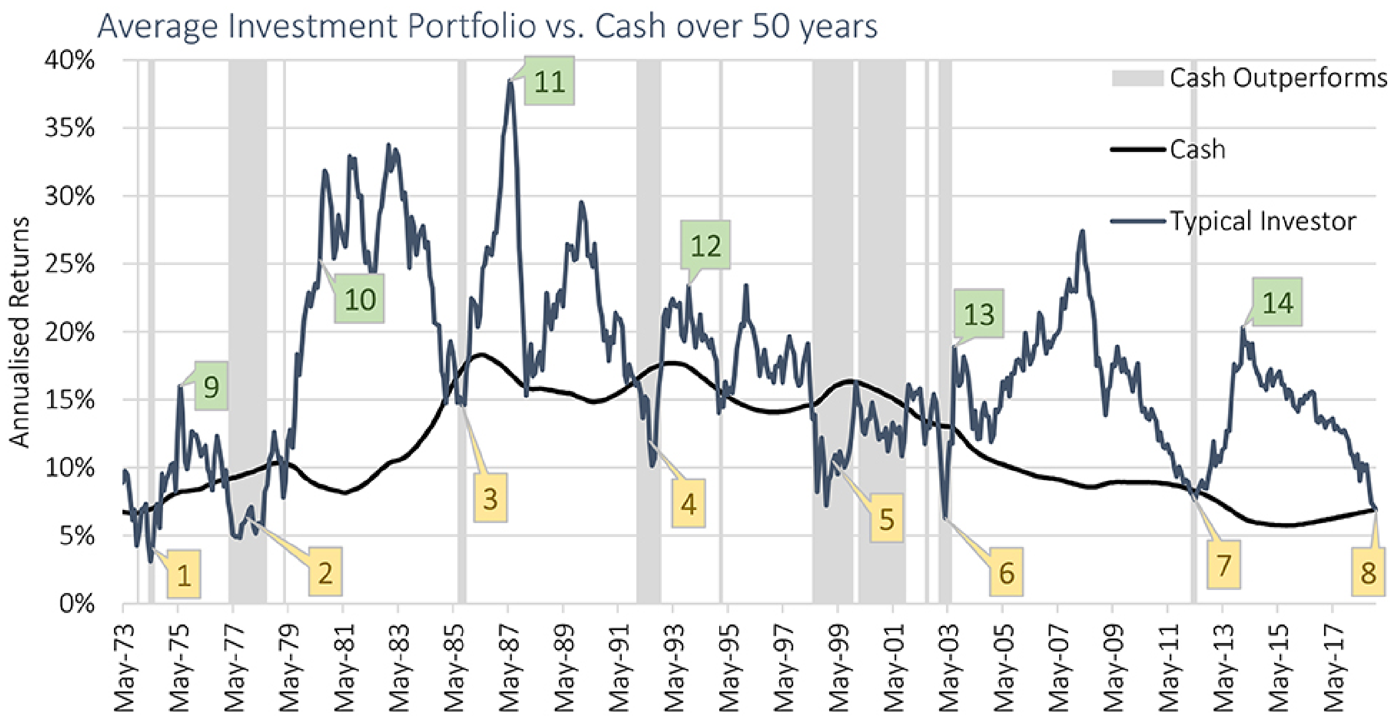
InvestSense

January 2019

Controlling the Controllables

Disappointing investment performance over the past few years has resulted in many investors starting to question the ability of the market to deliver on their long-term goals. In response, investors often try to correct for weak returns by making changes to their portfolios. Unfortunately, the reasons behind their desire to change are often emotionally driven, and are prone to error, which can lead to greater loss. To improve our chances of achieving success in our financial goals, we aim to understand what we can and cannot control and divert our efforts to "controlling the controllables". This is especially true during the current market environment.

Let's consider our current market environment for a moment. By the end of 2018, the average investor's portfolio[1] had underperformed a cash investment for five years. This is illustrated by point 8 on the graph below, where the five-year return on a typical retirement fund crosses the five-year return of an investment in cash. In other words, with perfect hindsight, an investor would have been better off invested in a fixed deposit over the past five years than in a typical retirement fund. Many investors have now sought to counter this through using cash investments, or similar low risk alternatives, in place of a growth oriented portfolio. Alternatively, they have avoided making new investments completely.



Source: FE Analytics, Thomson Reuters, Fundhouse

History provides us with some useful perspective. Firstly, we can see that investment returns do sometimes fall below cash. This has happened eight times over the last fifty years (see points 1 - 8 above). Secondly, we see that periods of weak performance are followed by periods of strong performance (points 9 - 14 above). And lastly, recoveries tend to happen rather quickly. The question we should be asking is not whether the market will recover, but rather how long until it does.

The problem we face is that many investors are responding to the weak performance in the markets by switching their investments to cash – but only after experiencing four years of weaker returns. This is a typical behavioural bias driven by fear and loss aversion that results in "selling low", i.e. after prices have dropped. Similarly, investors tend to miss out on some of the recovery by switching back into the market at higher prices, i.e. "buying high". Research studies[2] have shown that an investor's buy and sell decisions cost them on average 2.9%[3] per year in return foregone, relative to investors who hold on to their investments and resist the urge to change.

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FUNDHOUSE
investment clarity

On this basis, the patient investor retires with 60% more capital compared to the impatient investor![4]

The example above shows that we certainly don't have control over market performance and our reactions generally result in greater loss. So where does our circle of control begin and where does it end? We answer this question in the table below with some practical mitigation in dealing with the risks which fall outside of our control.

Event	Controllable?	Our Mitigation
Weak Market Returns	No	Patience; Diversify between shares, bonds, cash
Local political risk	No	Suitable exposure to offshore assets
Corporate fraud (e.g. Steinhoff, ABIL)	No	Diversify between different funds. Fund managers have different views on shares
Rand/currency	No	Diversify between local and offshore assets
Inflation	No	Suitable exposure to "growth" assets, like shares
Personal savings	Yes	Controlled through the financial planning process
Financial Planning	Yes	
Personal Cost control	Yes	

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Many of the uncontrollable forces that affect our portfolios can indeed be managed if we focus on what we can control first: By managing our personal finances, by implementing a sensible financial plan and by controlling costs. Within each of the "controllables" there are simple steps to follow to ensure we remain disciplined in managing our financial affairs:

Personal savings	• Be realistic about what your responsibilities are towards your long-term savings plan. • For long term investors, this means that personal finances should be managed in such a way that contributions can be paid without interruption caused by a weak economy. • Retired investors are most at risk when markets underperform, as their income is directly related to the value of their portfolios. Be realistic when setting your withdrawal rate. If markets have underperformed, it might be necessary to forego increases in your withdrawals for the next year. Save in the good times to support your expenses in the bad times.
Financial planning	• Seek independent and transparent financial advice. • Ensure that you have a sensible financial plan in place and that it remains relevant to your current circumstances. • Stay invested in the strategy outlined in your financial plan even when markets are struggling. • Avoid deviating from your financial plan by "de-risking" into cash or delaying investments. • Amendments to your investment portfolio should only be driven by changes to your financial plan (like providing for an unexpected liability) and never by short term performance.
Personal Cost control	In weak markets, investors often look for "alternative" investments which guarantee either the investment value or income but costs them through higher fees or lower returns. To protect themselves, investors should look to: • Avoid products that charge high fees for protection you don't necessarily need. • Avoid complicated products where the actual risks are not understood or aligned to your needs. • Avoid products promising unusually high returns (even from reputable institutions). When it sounds too good to be true - it often is. Often there are hidden costs or risks involved to deliver the return profile. • Costs are unavoidable, and the lowest fees are not necessarily the best option. Rather, look for transparency, fairness and value for money.

The temptations we face in investing are numerous, often expensive, and never obvious. If you feel that any of the decisions you intend making are in response to the events we refer to above, it may serve you best to do nothing. Capital preservation, financial discipline and a healthy dose of patience will ensure that the longer term investing goals remain on track.

[1] The portfolio of a typical long-term investor saving towards retirement.
[2] Dalbar releases an annual report that shows the impact of investor's decisions on their portfolio performance.
[3] Based on the 2017 Dalbar study, annual underperformance over last 20 years.
[4] Based on a 2.9% annual cost due to making changes, over a thirty-year investment horizon from age 30 to 60

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data provided by Reuters and Datastream

31 January 2019

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	3.8%	2.8%	-6.1%	6.4%	6.9%	13.4%	10.9%	13.2%
FTSE/JSE SA Listed Property	ZAR	6.6%	9.2%	-9.4%	2.8%	9.2%	13.2%	13.6%	13.3%
SA All Bond Index (ALBI)	ZAR	7.6%	2.9%	8.8%	10.5%	9.0%	8.3%	7.7%	7.0%
SA Cash Index (SteFI)	ZAR	1.8%	0.6%	7.3%	7.4%	6.9%	6.7%	0.2%	0.3%
Balanced Benchmark	ZAR	1.9%	1.8%	-0.2%	6.3%	8.0%	12.1%	7.2%	8.4%
SA Inflation (1 month lag)	ZAR	0.5%	-0.2%	4.5%	5.3%	5.3%	5.3%	1.4%	1.3%
GLOBAL MARKET INDICES									
Global Equity (Datastream World)	USD	0.8%	7.8%	-6.0%	11.9%	7.5%	12.1%	11.1%	14.2%
Emerging Markets Equity (Datastream EM)	USD	10.3%	8.8%	-13.9%	15.3%	5.2%	10.0%	15.3%	19.3%
Global Bonds (Barclays Global Bond Index)	USD	4.3%	1.4%	-1.1%	2.7%	0.8%	2.1%	5.3%	5.8%
Global Cash	USD	0.7%	0.2%	2.4%	1.5%	1.0%	0.7%	0.2%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	3.8%	2.8%	-6.1%	6.4%	6.9%	13.4%	10.9%	13.2%
Global Equity (Datastream World)	ZAR	-9.4%	-0.5%	5.0%	5.3%	11.3%	15.1%	14.9%	14.5%
Emerging Markets Equity (Datastream EM)	ZAR	-0.9%	0.3%	-3.8%	8.6%	8.8%	13.0%	13.1%	14.0%
SA All Bond Index (ALBI)	ZAR	7.6%	2.9%	8.8%	10.5%	9.0%	8.3%	7.7%	7.0%
Global Bonds (Citigroup)	ZAR	-6.2%	-6.5%	10.6%	-3.3%	4.3%	4.8%	14.1%	14.2%
COMMODITIES									
Gold (US Dollars)	USD	8.8%	3.2%	-1.4%	5.8%	1.3%	3.7%	13.2%	16.4%
Gold (Rands)	ZAR	-2.2%	-4.8%	10.2%	-0.4%	4.8%	6.4%		
CURRENCIES									
Rand / Dollar	ZAR	10.1%	7.8%	-11.8%	5.8%	-3.5%	-2.7%	15.5%	15.6%
Rand / GBP Pound	ZAR	7.5%	4.7%	-3.4%	8.2%	1.0%	-1.7%	16.2%	14.9%
Rand / Euro	ZAR	9.0%	7.4%	-2.9%	4.0%	-0.2%	-1.5%	14.5%	13.9%

Spot Rates		31-Jan-19	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	13.27	14.39	11.87	11.17	10.20	6.06
Rand/GBP	Rand	17.44	18.36	16.88	18.35	14.70	9.95
Rand/EUR	Rand	15.23	16.44	14.79	15.06	13.07	6.88
RATES							
Libor 6m $	US$	2.80	2.88	1.97	0.34	1.66	4.97
Repo Rate	Rand	6.75	6.75	6.75	5.50	11.50	18.83
Prime	Rand	10.25	10.25	10.25	8.50	15.50	22.00
All Bond Index Yield	Rand	9.36	9.64	9.21	8.99	10.28	NA
COMMODITIES							
Gold ($/oz)	US$	1,322.59	1,281.34	1,341.67	1,242.68	922.05	286.25
Platinum	US$	821.00	794.00	1,003.00	1,382.00	983.00	344.50
Oil (Brent Crude) $	US$	62.28	53.13	68.63	107.97	43.84	11.53
INFLATION							
SA Inflation	%	4.5	4.5	4.4	5.8	8.1	NA

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