



The Gale of Creative Destruction

We may look back on the year 2022 as the formative period for what drives investment returns over the next decade and longer. While it may feel like a period of wealth destruction, in fact it may be the birth of the next phase of wealth creation.

This concept of 'creative destruction' is not new. In Hindu mythology the three Gods Brahma the Creator, Vishnu the Preserver and Shiva the Destroyer work in a perpetual cycle with the belief that they need to co-exist so that balance is maintained between old and new.

Similarly, Joseph Schumpeter spoke about this concept as a natural process of evolution, where old systems need to die in order to be replaced with new ones.

Karl Marx applied it to finance and investments however: *"the idea of creative destruction or annihilation implies not only that capitalism destroys and reconfigures previous economic orders, but also that it must ceaselessly devalue existing wealth (whether through war, dereliction, or regular and periodic economic crises) in order to clear the ground for the creation of new wealth."*^[1]



The Trimurti (Shiva, Vishnu, Brahma); Schumpeter and Marx

It feels a little like Marx was on the money come 2022. We have all the features of his theory present in war (Russia/Ukraine), dereliction (Crypto-currencies) and economic crisis (inflation driving economic recession).

Is wealth really being destroyed? In some cases, yes. The FTX/crypto-currency failure has destroyed wealth. Arguably an investor holding global government bonds has also lost a substantial portion of their capital this year.

But we are talking about larger events here. The Global Financial Crisis in 2008/2009 was a period of wealth destruction which gave birth to a period of wealth creation. But this came with new rules: higher regulation on banks and the capital they hold; a new era of support and bailouts by governments; and suppressed interest rates which would continue for the next 14 years. These actions and others underpinned a massive period of wealth creation. The consequences of this phase are starting to be felt in 2022. Are we entering the next phase of creative destruction?

There are numerous examples of this theme playing out in global markets:

- The rise of sustainable investing, or "ESG" investing driving the destruction of industries such as fossil fuels, and the creation of industries such as electric-powered transport.



- Chinese regulation on how companies can profit from the population, while simultaneously creating ‘common prosperity’ is another example of creative destruction at work. Many Chinese technology-oriented companies have suffered in 2021/2022. What may we see a decade from now? Economic aspirations and human ingenuity will create a new opportunity for investors.
- Global political tensions have started to break down the globalization trend we have seen for several decades. “De-globalisation” is real and the destruction of the default outsourcing to the east approach is creating new investment opportunities for providers in other countries.
- Higher interest rates (important: they are not yet high! Just getting back to normal) have wreaked havoc on assets which have not factored in the potential that financial support from governments may wane. Does this drive the reallocation of investment capital away from longer term, higher growth industries with big payoffs, but big uncertainties, towards industries which are more visible, more tangible and where investment returns are more likely to be lower but positive?
- What to make of crypto-currency? The current destruction of value in this asset class may well lead to its viability in future. While it is built on the premise of ‘DeFi’^[2], the likely regulation to come – which is what happens when the man on the street loses their money due to mismanagement or dereliction – may well underpin a more viable approach to using this technology in future.

The current period of creative destruction is necessary, for without this release valve dampening financial excesses the problem may have become too big to fix. The GFC was a great example of this, born out of the Tech Bubble (1999/2000) and left to its own devices until it imploded in 2008. Recall also that Amazon and Google were born out of this tech bubble.

As investors we can’t change the course of history, nor can we change the mega-trends such as these highlighted above. But we can consider how to navigate these trends when looking to preserve and grow wealth.

Rule number one is don’t lose capital permanently. FTX is a perfect example of what to avoid here, as it fails not only an investment merit case, but also a financial due diligence case (the assets were not held in any form of safe custody, and the business was established outside of the ambit of strong oversight, transparency and regulation). We can mitigate this risk in wealth management by acting prudently with regard to what investments may be worth and ensuring that there is good governance in the underlying assets.

At times avoiding these risks or the pressures to invest where capital may be lost is harder than it appears. Your protection here is twofold: diversification (i.e. spread your investments across assets, regions, sectors, and currencies) and then position sizing (the amount of capital invested in any particular asset).

Rule number two is to be humble. Acknowledge that you don’t have all the answers, that the world is too complex to forecast, and that more things can happen than what you can consider may happen. Being humble does not necessarily mean you can’t make sensible investment decisions; in fact, it can help promote more sensible decisions as your typical behavioural biases and errors are less exposed.

Context is important here. As investors often with multi-decade timeframes, it means we will be caught up in both the excess of creation, as well as the devastation of destruction. But importantly, the trend is upwards. If you hold on, the repeating cycles of creative destruction work in your favour to build wealth.

Moods change quickly; just twelve months ago investors were positive, and returns were good. Where will we be in this creative-destruction cycle twelve months from now?

^[1] Source: Wikipedia

^[2] Decentralized Finance – or rather, outside of the reaches of governments



MARKET REPORT

31/10/2022

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	-1.3%	-5.7%	3.3%	9.8%	6.2%	9.5%	15.8%	13.6%
FTSE/JSE SA Listed Property	ZAR	-1.6%	-6.5%	3.0%	-6.1%	-7.5%	2.7%	27.7%	21.8%
SA All Bond Index (ALBI)	ZAR	-0.7%	-0.3%	3.1%	6.2%	7.9%	6.9%	8.2%	7.9%
SA Cash Index (SteFI)	ZAR	1.5%	4.1%	4.8%	4.8%	5.8%	6.1%	0.4%	0.4%
Balanced Benchmark	ZAR	-0.4%	-4.5%	2.4%	8.3%	6.7%	9.7%	11.1%	9.3%
SA Inflation (1 month lag)	ZAR	1.8%	6.7%	7.5%	5.2%	4.9%	5.2%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity (Datastream World)	USD	-6.7%	-19.7%	-18.1%	6.6%	6.9%	9.5%	17.7%	14.3%
Emerging Markets Equity (Datastream EM)	USD	-14.0%	-29.2%	-30.7%	-4.1%	-2.7%	1.2%	17.7%	16.1%
Global Property	USD	-16.9%	-27.8%	-24.2%	-3.7%	1.7%	4.7%	17.6%	15.0%
Global Bonds (Barclays Global Bond Index)	USD	-12.1%	-25.2%	-25.6%	-7.8%	-3.0%	-1.3%	7.5%	6.7%
Global Cash	USD	0.9%	1.6%	1.6%	0.9%	1.5%	1.0%	0.3%	0.3%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	-1.3%	-5.7%	3.3%	9.8%	6.2%	9.5%	15.8%	13.6%
Global Equity (Datastream World)	ZAR	2.9%	-7.6%	-1.0%	13.9%	12.7%	18.0%	17.1%	15.4%
Emerging Markets Equity (Datastream EM)	ZAR	-5.1%	-18.4%	-16.2%	2.5%	2.5%	9.0%	13.9%	13.3%
Global Property	ZAR	-8.3%	-16.8%	-8.3%	2.9%	7.2%	12.8%	18.2%	15.5%
SA All Bond Index (ALBI)	ZAR	-0.7%	-0.3%	3.1%	6.2%	7.9%	6.9%	8.2%	7.9%
Global Bonds (Barclays Global Bond Index)	ZAR	-3.0%	-13.8%	-10.0%	-1.5%	2.2%	6.4%	15.6%	13.7%
COMMODITIES									
Gold (US Dollars)	USD	-7.2%	-10.1%	-7.8%	2.7%	5.2%	-0.5%	12.8%	14.4%
Gold (Rands)	ZAR	2.4%	3.5%	11.5%	9.8%	10.9%	7.2%		
CURRENCIES									
Rand / Dollar	ZAR	-10.3%	-15.1%	-20.9%	-6.9%	-5.4%	-7.8%	16.1%	14.8%
Rand / GBP Pound	ZAR	-4.4%	2.1%	-1.6%	-2.8%	-2.4%	-4.2%	14.4%	14.6%
Rand / Euro	ZAR	-6.9%	-0.1%	-3.3%	-2.6%	-2.0%	-4.9%	14.2%	13.5%

Spot Rates		31-Oct-22	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US\$	Rand	18.4	18.0	15.2	14.1	8.7	10.0
Rand/GBP	Rand	21.2	20.1	20.8	18.8	14.0	15.7
Rand/EUR	Rand	18.2	17.6	17.6	16.5	11.3	9.9
RATES							
Libor 6m \$	US\$	4.9	4.2	0.2	1.6	0.5	1.6
Repo Rate	Rand	6.25	6.25	3.50	6.75	5.00	13.50
Prime	Rand	9.75	9.75	7.00	10.25	8.50	16.00
All Bond Index Yield	Rand	11.4	11.4	11.6	9.7	7.3	9.7
COMMODITIES							
Gold (\$/oz)	US\$	1 638.0	1 674.1	1 776.8	1 269.5	1 724.2	317.0
Platinum	US\$	935.0	864.0	1 009.0	915.0	1 570.0	579.0
Oil (Brent Crude) \$	US\$	95.8	88.2	84.4	61.1	109.9	25.7
INFLATION							
SA Inflation	%	7.5	7.5	5.0	4.8	5.8	9.4

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