

## Issue 53: December 2011

With the end of 2011 in sight most investors wish that 2012 will hold in something better. To say the least, total return figures (including dividends) of the JSE ALSI over the last 12 months were dismal.

One must remember that although the market turmoil creates fear amongst investors, it is a sign of change; and change brings about new opportunities and potential economic growth. A visible example is climate change – the direct result of irresponsible environmental policies. Now new technology is required to combat it. The debt crisis in turn is the result of unsound lending practices. The lenders are as guilty as the borrowers and someone will ultimately pay the price for being greedy. The mere existence of countries and interlinked economies cannot be wished away and a solution must be found. Global markets will benefit from this change and will continue (over time) to be a more profitable investment decision than leaving your money in the bank.

### How do you measure returns?

So when do we have “good” or reasonable returns? Returns should be measured relative to market conditions or the business environment. Hence, we prefer comparisons with inflation i.e. during high growth periods inflation creeps up and during a downward cycle inflation tends to be lower. Through various cycles an investment strategy should outperform inflation and increase your purchasing power - providing **real** growth of assets. For example:

Nominal Return	Inflation (CPI)	Real Rate
15% pa	10%	5% (15-10)
10% pa	5%	5% (10-5)

### In or out of the “market”...

With extreme volatility do I need to be in a money market investment? This question is at the heart of **sound** financial planning. The question should rather be: could I weather a dip? In other words, will I be forced to sell assets in order to fund my lifestyle? When it comes to investing, what is the biggest risk: market risk, company or institutional risk, interest rate risk, inflation risk? For many investors it is simply “losing” money. Because this is a powerful fear provoking visceral reaction, many investors turn to market timing; i.e. buying or selling based upon future predictions.

One of the toughest questions is when to enter the market after a major down-turn. Impulsive investors, who abandoned the market during sharp down-turns in 2008, would have missed the strong ensuing rebounds in 2009 and 2010. In other words some investors (still in cash), waited too long before buying back in order to enjoy a recovery.

First remember why you invest? Some of us have shorter goals e.g. tuition for children or a holiday and others invest for the long-term such as a comfortable retirement supporting a specific lifestyle. Secondly, volatility in the near term is absolutely normal. As a financial coach, we are making a point of knowing you as well as your needs. We need to help our clients avoid making emotion-driven mistakes during turbulent times. We need to be consistent and advise you during good **and** rough times; therefore, we [Finsolnet-Sygnia] crafted an investment strategy with the emphasis of managing risk while producing consistent and “predictable” returns during all market conditions.

However, what is the risk of not being invested? Choosing when to invest, or to “time” the market is inherently difficult. Investors who time the market also run the risk of missing periods of exceptional returns. Over long periods (greater than 15 years) the financial markets are remarkably steady. To illustrate this point we have taken data represented by a broader financial index, the S&P500®

Period 1974 – 2007	Average Total Return
Fully invested over period	13.4% pa
<b>Minus</b> the 20 Best days	10.8% pa
<b>Minus</b> the 30 Best days	9.8% pa
<b>Minus</b> the 50 Best days	7.8% pa

From historical data (see above) it is clear that market timing can seriously diminish long-term performance. But this view is probably too simplistic. Solid investment management is **not** about predictions, but rather risk management (the optimal blend between various asset classes).

### A passive versus active approach

In the past we have addressed the differences between **passive** and **active** investing. A passive approach prefers a “tracker” or ETF (an Exchange Traded Fund). An ETF is a basket of securities (mostly equities) which trade like a single equity on the stock exchange; in other words the price is determined throughout the day but the underlying assets do not change. In comparison, the unit trust funds’ price are determined at the end of the trading day and the unit trust may take various investment strategies e.g. the asset class composition may vary over a period of time.

The first ETF in South Africa was launched in 2000 which was the Satrix Top 40 (tracking the top 40 shares on the JSE) and is probably the most well-known ETF in South Africa. Currently there are many of these instruments usually marketed as “lower” cost alternatives. However, do they deliver the intended results? In order to provide context we have compared the Satrix Top 40 with 3 other actively managed funds in South Africa – all after fees.

30 September 2011	1 Yr	3 Yr	5 Yr
Satrix Top 40 (Passive)	3.1%	8.9%	7.6%
Fund A (Active managed)	6.7%	12.4%	10.8%
Fund B (Active managed)	6.1%	16.1%	14.1%
Fund C (Active managed)	6.8%	14.5%	12.2%

As you would expect, there is no superior investment – providing high returns in a short timeframe with no risk (zero volatility), but an active approach by reputable managers have proven their ability to outperform the benchmark indexes. Therefore we believe that a selective process during investing should add value to investors. Utilising thorough portfolio planning we consider **calculated risk** as well as the **time period** over which we would like to attain the projected **real return**.

### Season Greetings

We want to wish our clients a Merry Christmas as well as a happy New Year. 2011 certainly delivered its own surprises – the death of Gaddafi, the sacking of Berlusconi and the expulsion of Julius Malema from the ANC. Let’s hope we are on a path of global financial recovery.