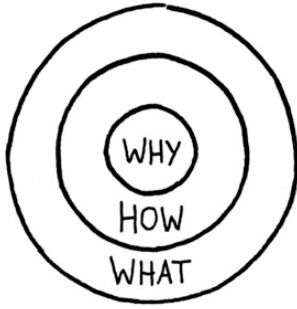


Why instead of what

Issue 61: June 2013



Simon Sinek studied exceptional businesses and leadership which lead him to develop "The Golden Circle of Truth". What struck me about his concept was the utter simplicity and that *the deeper motivation of*

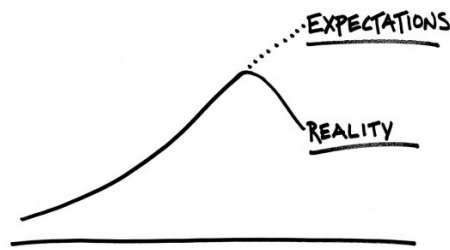
human actions are typically locked up in "why" questions. Take note of how many times children ask *why* questions... why this and that, while adults have somehow managed to build up so many layers of assumptions about certain things. For example we will ask someone *what* he or she does (implying his or her profession), but not *why* they do it? Knowing that less than 10% of all working adults enjoy what they are doing, it is well possible that someone is not passionate about their job and just plugging away to pay the bills.

There is an important lesson here when we evaluate our financial plan and a sound investment strategy. By asking an important *why* question, one should ensure that the deeper motivation [of the advice and investment] is aligned with your personal goals and objectives. Proverbially hitting the bull's eye! Traditionally financial planning has been the completing of a few forms and ticking off boxes with a risk profile. We completely disagree with this approach. Thorough wealth planning entails meaningful personal conversations, the analysis and evaluation of alternatives while one should engage individuals in key areas of competency during the entire process.

Ariba, Inc.



The graph above from *Google Finance* illustrates the performance of Ariba, Inc. since its IPO (Initial Public Offering) in 1999; i.e. when it started to trade on the NASDAQ stock exchange in America. Most people will be hesitant to share a story where they have lost money – it is embarrassing only if you have not learnt something from it. My story is about Ariba, Inc. At the time I lived in San Francisco and Ariba was one of the promising Internet companies of the Dotcom era. An electronic business-to-business exchange platform, Ariba rated amongst the Ebay and Amazon.com of the day. Ariba had a legitimate business model (not like the other Dotcoms that went bankrupt shortly after the market crashed); and SAP, the German enterprise software maker, acquired Ariba in September 2012 for



\$4.5bn. I invested early 2000 and sold at a loss in 2001 (indicated by the green and red arrows in the graph). So what did I

learn from this expensive exercise?

- Analysts as well as investment brokers tend to get swept up in euphoria; also unable to judge whether the company and market fundamentals are sound
- You have to somehow determine the probability of success. Sometimes the risk of disappointment can be extremely high; especially if you are much older because you don't have any time to fix such a "mistake" (the graph and illustrations are by Carl Richards, The Behavior Gap)
- Good wealth planning is **not** about betting on companies such as the next Google or Apple; this could lead to a series of random decisions with no outcome

How could we evaluate an investment?

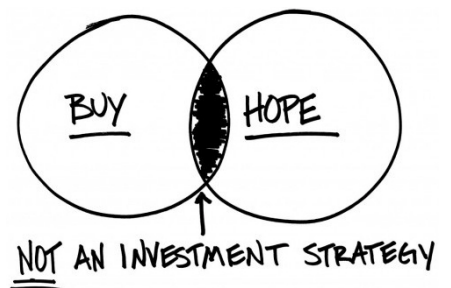
There are several factors one should or could consider during an **investment process**, but one element that is often overlooked is the probability of a successful outcome. In other words, how sure am I that my choice will turn out to be a good one? Take the following example:

- Investment A: $0.15 \times 20\% = 3.0\%$ [expected return]
- Investment B: $0.85 \times 10\% = 8.5\%$ [expected return]

While Investment A has a potential rate of return of double that of Investment B, its expected return is significantly lower (an expected return of 3% over 8.5% of Investment B). Thus judging your investment options you should clinically reason as follows:

1. Have I been wrong in the past?
2. Why and what happened?
3. What is the chance of being wrong again?

We acknowledge that the example above is perhaps an over simplification of the probability notion, since there is no way that one can assess all the variables in the



equation; however, during any given investment process one should determine what the probability is of being wrong. Making an investment with a low probability of success remains a bad decision even though the outcome could have been a good one; implying that you were just lucky. For this reason it is always prudent to diversify.

At Afrafin our inflation strategies are constructed in this manner; to obtain the appropriate exposure to the various asset classes and management styles thus increasing our chances of a successful outcome.