STANLIB Multi-Manager

The Educator

May 2021 practice note

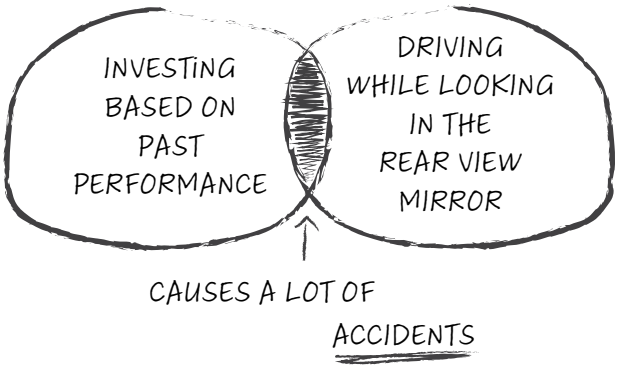
In The Educator, we address a number of topics with the ultimate goal of providing a better understanding of investing clients' money.

How to reduce the number of accidents – do not forget your time horizon

Past performance remains highly correlated to investment flows

The local Collective Investment Schemes (CIS) industry attracted net annual inflows of R213 billion in 2020 – the highest ever in the 55-year history of the industry. The majority of the flows (86%) went into interest bearing portfolios i.e. money market and income portfolios.

This should not come as a surprise as these portfolios have been the best performing 'asset class' in the local market over the past three to five years. Quite simply, cash has been king. However, we know that investing based only on past performance can cause a lot of accidents.



Source: Carl Richards

Focus on your goal(s) first

Your time horizon – the period over which you need to invest in order to meet your investment goals – should influence your willingness to take on more or less risk. It is a component that can help to align investment goals with risk tolerance and ultimately, the portfolio you consider investing in.

You therefore need to ensure that your money is invested in line with your investment goal(s) and not necessarily in the best performing asset class over the recent past. Your **long-term** investment needs **SHOULD** not be in 'short-term funds' (portfolios with short-term outcome expectations such as money market and income funds). Furthermore, **short-term** investment needs **SHOULD** not be invested in 'long-term funds' such as growth portfolios (a range of multi-asset portfolios with varying allocations to equities).

Investors with shorter time horizons usually select conservative portfolios – and rightly so. Conversely, investors with longer time horizons are required – and are often more willing – to take on more risk in order to meet their longer-term needs.

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Money market/income investments ≠ achieve your longer-term goals – why not?

Low 'win rate' for money market – looking backwards

Specific time comparisons can be problematic as they promote investor biases, with investors often losing sight of the bigger picture. To illustrate this concept, let us look at the ASISA Multi-Asset High Equity category (refer the figure that follows). The category is typically measured over a five-year time horizon and has fallen victim to the 'cash is king' narrative. However, looking at the past 10 years through the lens of a win rate shows a very different picture. The figure below shows that if we consider **every** investable five-year window over the past 10 years, high-equity has outperformed cash 71% of the time. And when high-equity does outperform, it does so with a wide margin – an average of 2.99% outperformance. On the other hand, the margin of underperformance is a far more modest -0.34%.

Figure 1: Win/loss ratio

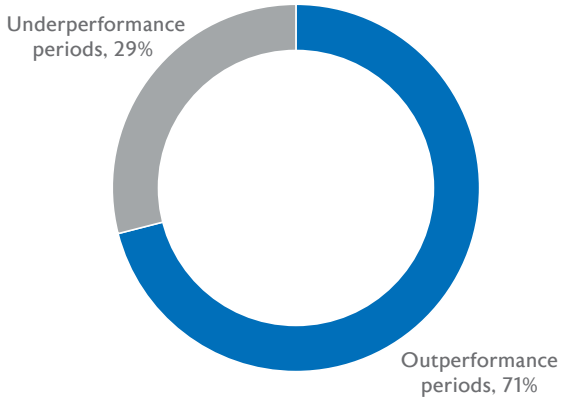
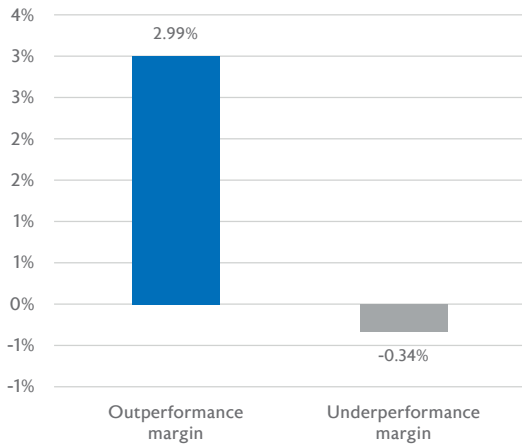


Figure 2: Win/loss margin



Source: Moneyweb /Soapbox – What's your win rate? (8 March 2021). Period of measurement is 1 January 2011 to 31 December 2020 using all possible 5-year rolling windows in daily steps.

Lower real earnings on cash – looking forward

We have seen significant and rapid cuts in interest rates in South Africa. This necessitates the need to take a rain check, look forward and acknowledge that cash rates are at 50-year lows, which is not going to help beat inflation. According to calculations made by Prudential Investment Managers last year, cash-related investments are only likely to return approximately 0.2% p.a.[1] more than inflation over the next three to five years.

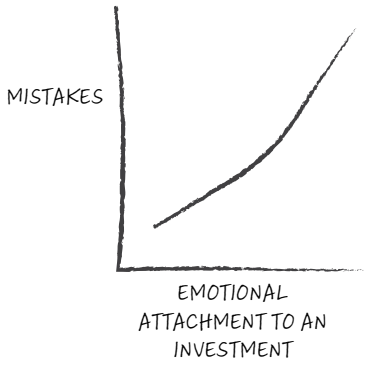
So, if you are saving or investing towards a short-term goal, you should be able to protect your money in real terms. However, if your goal is for the medium to long term, then cash-type investments will in all likelihood, not meet your needs and take longer to reach, thus not meeting your outcome expectations. This is why you should let your time horizon (your needs) dictate your most suitable portfolio.

Unfortunately, investors tend to be a bit late to the party, which is why it is crucial to emphasize that, at this point in time, money market type funds will not provide the requisite return to beat inflation over the long term. Investors need to start looking forward rather than in the rear view mirror at the eye-watering returns from interest-bearing portfolios – money market and income plus – over the past five years. Proven by the 'win rate' and what to expect from cash going forward.

The challenge is not to find better investments, but to become a better investor

Investing is an exercise that requires discipline, patience and stamina.

Unfortunately, humans are hardwired to react to our emotions in the present at the expense of our future selves. With planning our goals, separating long-term needs from short term investments can help to avoid recency bias, whereby investors favour recent events over historic ones by giving greater importance to them.



[1] *Prudential: May 2020: 4 ways SA's interest rate cuts impact you as an investor.*

Source: Carl Richards

To summarise

- The numbers/statistics continue to show what we do not want to see – money invested in portfolios based on past performance. Remember, past performance is not necessarily a guide to future performance
- We can mitigate recency bias with investment discipline – remove emotion from your decisions and focus on your investment goal(s)
- The time horizon required to meet your goal(s) will direct you towards a suitable portfolio. This removes decision-making that is based solely on past performance and might result in your portfolio not being aligned with your investment goal(s).

This article originally appeared in the "Did you Know?" section of the Internal GoalStandard Range of Funds publication.

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