STANLIB
MULTI-MANAGER

Future Focus

March 2024

Welcome to the Autumn Edition of Future Focus – insights on building wealth for your clients

- **Talking point:** Geopolitical risks – choosing the right navigator.
- **Investment centre:** How to measure asset manager skill.
- **Manager insights:** SA equity manager responses to the higher offshore limit.
- **Practice notes:** How you can benefit from a market 'sabbatical'.

We hope you find relevant insights in this edition.

STANLIB Multi-Manager Investment Team

Talking point | Investment centre | Manager insights | Practice notes

Talking point

Geopolitical risks – choosing the right navigator

> "The growth of nationalism, protectionism and populist movements in recent years has created an environment of increasing uncertainty and could potentially lead to deglobalisation". **– S&P Global**

Key points

- **Geopolitical divides could create a more 'fragile' global economy.**
- **We use as many levers as possible to optimally diversify your portfolio.**
- **A reputable DFM, with a proven record in managing risk can guide investors through the ongoing geopolitical challenges**.

A world that has been ordered by globalisation and geoeconomics for decades, has quickly become a world stranded in geopolitical risk. Persistent regional conflicts, trade wars, more frequent cyber-attacks and rising nationalism has ripple effects globally, with vast commercial impact on industry stability and business operations. Prices fluctuations, supply chains and investment flows pose major challenges for investors.

Regardless of what your thoughts or views are of the current geopolitical climate, the world is filled with noise and emotion – at levels many of us have never experienced in our lifetimes. In this article, we set out some of the likeliest and most impactful geopolitical risks of 2024 and the important role DFMs and financial advisers must fulfill to help clients to navigate the uncertainty and associated investment risks.

Geopolitical minefields

Geopolitical risk can be categorised into several interconnected and often overlapping types.

Regional conflicts

The conflict in Gaza, the Red Sea shipping battles; and the ongoing war between Russia and Ukraine are all contributing to massive global uncertainty, triggering energy price fluctuations, global supply constraints, refugee crises, and broader market volatility. Understanding the potential impact of these conflicts on specific regions and asset classes is crucial for informed investment decisions.

Trade wars

The two largest economies in the world have been locked in a bitter trade battle. It started in 2018 when the US began setting tariffs and other trade barriers on China with the goal of forcing it to make changes to what the US says are longstanding unfair trade practices and intellectual property theft.

In China, there is a perception that America is trying to curb its rise as a global economic power. The ongoing dispute has seen the US and China impose tariffs on hundreds of billions of dollars' worth of one another's goods. Investors face exposure to these disruptions through various sectors, demanding careful consideration and potential adjustments.

Cybersecurity

The data breach at Yahoo is one of the worst and most infamous cases of a known cyberattack and currently holds the record for the most people affected. A team of Russian hackers targeted Yahoo's database using backdoors, stolen backups, and access cookies to steal records from all user accounts. Initially, Yahoo reported stolen data from about 1 billion accounts, however, after Verizon bought out Yahoo in 2017, they reported that the final number of records affected totalled about 3 billion accounts.

The risk rating of major cyber-attack(s) is at a high level and the ongoing attacks highlight the vulnerability of critical infrastructure. Sophisticated cyber-attacks targeting businesses and governments, can lead to devastating data breaches, financial losses, and reputational damage. Companies across industries are vulnerable and need to assess their exposure and mitigation strategies.

> Cybercrime projected to hit $10 trillion annually by 2025 **- University of San Diego**

Nationalism and populism

Anti-globalisation sentiment and inward-looking policies championed by some governments can hamper international cooperation and trade. This impacts global economic growth and has the potential to lead to market isolation for specific sectors. Many investors are bracing for the return of Donald Trump – a Trump presidency could bring sharp policy reversals in 2025 and include steep import tariffs and a potential exit from NATO. The consequences of these potential policy changes should be on the radar screens of investors.

Talking point

Geopolitical risks – choosing the right navigator (cont.)

Diversification...a powerful tool

> "Diversification is the process of allocating capital in a way that reduces the exposure to any one particular asset or risk by investing in a variety of assets or across many risk factors." - **Joao Frasco, Liberty DFM: CIO**

With the right strategy, diversification can be a powerful tool for building a resilient and successful investment portfolio, even in a world filled with geopolitical uncertainties. It is the diversification across asset managers – investment philosophies and styles – asset classes, sectors, geographies that helps to mitigate the impact of any single geopolitical event and smooth out portfolio volatility.

Examples include:

Spreading the impact

A single event might cripple a specific region or industry, but it is unlikely to affect everything simultaneously. By diversifying across different geographic regions, asset classes, and sectors, you can ensure that the negative impact of any event is spread thin, minimising the overall effect on your portfolio.

Reducing dependence

Over-reliance on any single country or region leaves you vulnerable to its political whims. Diversification breaks that dependence, offering exposure to economies with different political systems and risk profiles. This reduces the sensitivity of your portfolio to events in any specific location, making it less susceptible to sudden shifts in policy or leadership.

Capturing global growth

The world is a vast and diverse marketplace and by limiting yourself to one region, you could miss out on exciting opportunities elsewhere. Diversification opens doors to the growth potential of different economies, allowing you to benefit from advancements and innovations happening around the globe, regardless of local political landscapes.

Long-term perspective

Geopolitical events often create short-term disruptions, but their long-term impact is usually less severe. Diversification encourages a long-term view, allowing you to ride out these temporary waves of volatility and focus on the underlying fundamentals of different economies and assets.

Choosing the right navigator

Partnering with a reputable DFM with a proven track record is certainly a good start to protecting your advice practice and more importantly, your clients during geopolitical uncertainty. DFMs conduct thorough risk assessments, stay informed about geopolitical trends and adapt investment strategies accordingly. Hence, partnering with a DFM can help clients navigate these uncertain times with greater confidence and potentially achieve their long-term financial goals. BUT selecting the right DFM requires careful consideration. Key aspects to bear in mind include:

- **Experience in managing geopolitical risks:** look for a DFM with a proven track record of navigating past geopolitical challenges and demonstrably adapting their strategies accordingly.
- **Investment philosophy and approach:** ensure the DFM's philosophy aligns with your clients' risk tolerance and investment objectives.
- **Track record and performance:** evaluate the DFM's historical performance against relevant benchmarks.
- **Research capabilities and resources:** ascertain the depth and quality of the DFM's research team and their access to global intelligence sources.
- **Transparency and communication:** choose a DFM that prioritises clear communication, keeping both advisers and clients informed about relevant developments and portfolio adjustments.

In conclusion, the current geopolitical landscape demands a proactive approach to risk management. By leveraging the expertise and resources of an experienced DFM, advisors can empower their clients to navigate uncertain waters with greater confidence and achieve their long-term financial aspirations.

Remember, in a sea of uncertainty, choosing the right navigator can make all the difference.

Leigh Kohler
STANLIB Multi-Manager

How to measure asset manager skill

Key points

- **Identifying manager skill requires going beyond past performance. It involves a blend of quantitative analysis, statistical verification, and qualitative assessment.**
- **Statistical techniques such as hypothesis testing and regression analysis are crucial in trying to differentiate manager skill from luck.**
- **The above is a necessary but not a sufficient condition to assess future performance potential.**

Asset managers will almost always show their fund performance relative to some benchmark and any outperformance is often misunderstood to reflect the skill of the manager. In this article we endeavour to demonstrate that outperforming a benchmark does not necessarily mean that the manager is skilful, but rather that their performance could be the result of luck.

Importance of discerning skill

The difference between employing skilled and unskilled asset managers can result in a huge dispersion in returns. This dispersion widens as the investment horizon increases, compounding the importance of being able to identify skilful managers. For example, over the 12 months to 31 January 2024 in the ASISA High Equity Category, the fund with the highest return delivered 40.1%, while the fund with the lowest return lost 7.1%, a difference of 47.2% in a single year.

Outline of the challenge

It would be simple if all we had to do was pick past winners (best performing funds), implicitly assuming that these would represent skilful managers. However, the research (including work that we have done ourselves) suggests that this would not result in great outcomes. The disclaimer that past performance is not necessarily a guide to future performance is apropos. Teasing skill from past performance is notoriously difficult because capital markets are very 'noisy' (stochastic or random), which makes finding skill 'a signal in the noise' akin to finding a needle in a haystack.

Although past performance is far from useless, knowing how and when to use it requires a good understanding of the tools available to do this. More importantly, understanding the need for a qualitative approach and not just relying on quantitative assessments is critical.

The past versus the future

If that was not complicated enough, we also need to understand that most investors are interested in future performance, not past performance. The reason for trying to find skilful managers, is so that capital can be deployed with them, with the understanding that they are more likely to outperform in the future. Simply identifying skill in past performance would be of limited use. An example would be giving managers awards for their skilful past performance, although most awards do not even do that – they simply give awards to the best performing funds, not to the most skilful fund managers.

Quantitative analysis

- **Alpha generation:** alpha represents a manager's outperformance (or underperformance if alpha is negative) relative to an 'appropriate' (valid) benchmark. The word 'appropriate' does a lot of heavy lifting in that definition, disqualifying many benchmarks such as inflation and peer group averages.

  The problem, however, is that positive alpha alone, does not tell you whether a manager has skill (or more accurately, was skilful) or was simply lucky. This is often a major source of misunderstanding of alpha as many people do not recognise how to extract a signal from a random variable. In a later section, we will cover a statistical technique where we can do exactly this.

- **Risk-adjusted returns:** sometimes alpha can be a simple product of the risk taken by the asset manager relative to the benchmark. Unfortunately, just calculating the alpha does not provide you with this important risk information. The industry has therefore designed risk-adjusted return metrics that adjust the alpha for the amount of risk taken to achieve it.

Investment centre

How to measure asset manager skill (cont.)

Sharpe ratio
Total risk taken

One such metric is the Sharpe ratio, which measures alpha as the return in excess of a risk-free rate, and the risk as the volatility of the returns. **The Sharpe ratio therefore measures the excess return per unit of total risk,** allowing two funds that have taken different amounts of risk to be compared.

Information ratio
Active risk taken

The Information ratio measures the alpha relative to an appropriate benchmark, and the risk as the volatility of the active returns i.e. the difference in the fund returns and the benchmark returns measured with a certain frequency e.g. monthly. **This metric therefore measures the alpha per unit of active risk,** again allowing for the comparison of funds that deploy different levels of active risk.

Treynor ratio
Systematic risk

Another metric is the Treynor ratio, which is similar to the Sharpe ratio in how it measures alpha (relative to the risk-free rate) but uses systematic risk (often referred to as beta) as the risk measure. **This metric therefore measures the alpha per unit of systematic risk,** allowing for the comparison of funds with different levels of systematic risk.

- **Benchmark comparison:** as highlighted, using an 'appropriate' benchmark is critical in calculating alpha, but it is equally important in calculating active risk. This may be more obvious if you consider what active risk purports to measure, which is the dispersion of fund performance relative to the benchmark. If the benchmark is not appropriate, this relative performance is meaningless. A fund manager may have made the right call in investing in a specific stock, but not receive the appropriate credit for doing so if the benchmark does not recognise this. While we have already mentioned that some benchmarks may not be appropriate in general e.g. inflation, some may also not be appropriate for a specific fund as they do not represent how that manager is investing.

> An appropriate benchmark is critical

- **Consistency of performance:** another way to measure performance is to simply calculate the proportion of outperformance of the benchmark using a certain frequency e.g. monthly or even daily. Here we ignore the amount of outperformance or underperformance, and simply focus on the relative frequency of each. If we assume that a manager simply picks stocks by flipping a fair coin, we would expect the manager to only get around 50% of their calls right, leading to outperformance. We need to recognise that this would be a random variable with a random outcome, and one could not simply infer that a number above 50% would be evidence of skill. Again, later we will describe how we can use statistical techniques to establish whether certain results suggest any evidence of skill or not. It is, however, important to note that you need to use non-overlapping periods when doing this analysis, and many people fail to recognise this, thus invalidating any results.

> Using overlapping returns is meaningless

- **Attribution analysis:** if you want to truly understand whether a manager is skilful or not, you need to understand where any outperformance has come from. This is where attribution analysis comes into play. If a performance measurement such as alpha, tells you how much the fund outperformed the benchmark, attribution analysis tells you what contributed to that outperformance.

  How the attribution is performed is important because it will only attribute the performance to the variables being measured. For example, if you wanted to understand a fund's relative performance in terms of its asset allocation and stock selection decisions, you would need to use these variables in the attribution analysis. Again, simply assuming that a positive attribution value is evidence of skill fails to recognise that these are random variables requiring statistical analysis to separate any 'signal' from the 'noise'.

Statistical analyses

- **Hypothesis testing:** as mentioned above, simply using alpha or the proportion of outperformance as a measure of skill fails to recognise that these results are possibly random, and luck may be mistaken for skill. Fortunately, there are statistical techniques that help to put these metrics in the context of how random they are i.e. it allows us to extract any 'signal' (skill) from the 'noise' (randomness). Hypothesis testing is the specific tool that can be used to do this. Under certain assumptions, which should always be validated as they are often wrongly ignored, you can postulate that a manager has no skill under the null hypothesis, and then look for evidence that will allow you to reject that null hypothesis. This test can be performed on alpha and on the proportion of events – days or months – of outperformance.

  It is important to understand that these tests simply provide evidence in support of rejecting the null hypothesis that the manager does not have skill – or is failing to do this. It does not prove anything as statistics does not prove, but rather provides evidence in support of the null hypothesis, or the alternative hypothesis.

- **Regression analysis:** another important tool in our toolkit is regression analysis, which helps to dissect manager performance in many different ways. In simple terms, a regression analysis helps to understand how independent variables may be used to explain fund performance. This can be very powerful in various exercises, including understanding a manager's style bias – if they have one, or even that they do not have any – as well as the amount of systematic (beta) risk taken which was discussed above in relation to the Treynor ratio. Beta is the slope – sensitivity – of a linear regression of the fund's performance relative to the benchmark, traditionally, a market index.

Qualitative analysis

- **Investment philosophy and process:** unfortunately, quantitative analysis may not be enough to establish whether a manager has skill. We spend at least as much time on qualitative analysis as we do on quantitative analysis. The starting point in understanding a manager

How to measure asset manager skill (cont.)

qualitatively, is to understand their investment philosophy and process. The investment philosophy is meant to reflect the manager's alpha thesis – why they believe that they can outperform – and their investment process is meant to reflect how they organise themselves to harvest that outperformance (alpha).

The investment process is extensive in range and scope, covering everything from how stocks are analysed, to how portfolios are constructed, including position sizes and sell disciplines. This is where you can start seeing how the future could be informed by the past. While many managers may not make revolutionary changes to their philosophy and process on a regular basis (unless something is seriously 'broken'), many will keep evolving with the passage of time. Understanding how these changes may impact future performance is therefore critical in assessing whether a manager's skill will persist.

- **Experience and track record:** to think that the assessment of past performance is a purely quantitative and objective exercise, would be to misunderstand how much qualitative and subjectivity goes into analysing past performance. To begin with, analysing past performance has very little to do with simply comparing how a fund has performed relative to a benchmark or peer group. Instead, it includes many different dimensions of that past performance, including:

1. **What fund(s) to analyse and what benchmark(s) to compare to.**
2. **What period to use in the analysis and how this is informed by the market (e.g. cycles).**
3. **The asset allocation and stock selection over the period and how this has changed.**
4. **The transactions (buys and sells) executed and the basis for these decisions.**

In addition, the team and philosophy and process together with other factors like fees, fund size, objectives (explicit and implicit) etc., are all critical in understanding past performance.

- **Team and resources:** although last, people are in fact the most important qualitative factor that we consider. Almost nothing else matters if you have the 'wrong' people in the investment team. We need to evaluate people along various dimensions, including their qualifications, skills, and experience. This is done at the individual level, but the evaluation of the team, as a collective, is equally important. We are not believers in the 'star' portfolio manager philosophy, but rather in the wisdom of crowds.

  A diverse team of skilled individuals will, on average, outperform a single portfolio manager over time and will typically avoid outlier performance, both positive and negative. Although this may sound like it will lead to average performance, it is a poor understanding of how small positive results compound over time and reduce risk significantly. Finally, people do not operate in a vacuum – their access to data and systems/tools is very important. We therefore spend time understanding their resources to establish how these will support the investment philosophy, process, and people.

Conclusion

In the quest to identify manager skill, a multi-faceted approach is non-negotiable. Quantitative measures provide a starting point, but without the statistical methods to sieve through the randomness, as well as the qualitative assessment of the philosophy, process, and people, the analysis remains incomplete. It is the blend of numbers and narrative that brings us closer to the truth. A manager's historical performance is a canvas, but the true art lies in interpreting the brushstrokes – the investment philosophy, the rigor of the process, the adaptability to market conditions, and the collective wisdom of the team.

Evaluating a fund manager's skill is as much about understanding the past as it is about anticipating the future. It is an exercise in balancing evidence with insight, and data with judgement. As the investment landscape evolves, so too must our methods of discerning skill, always cognisant of the complex, dynamic interplay between luck, talent, and the inexorable march of the markets.

Joao Frasco
STANLIB Multi-Manager: CIO

Manager insights

SA equity manager responses to the higher offshore limit

Key points

- **Data shows that SA equity managers have not rushed to increase their offshore exposure.**
- **Our survey revealed a diverse response – from strategic views to mandate restrictions.**
- **Business models are expected to evolve to boost the depth and breadth of offshore markets.**

Introduction

In February 2022, South Africa's financial landscape underwent a significant shift as the investment allowance for local retirement funds was increased from a 30% allocation to global assets and 10% to African assets, to a 45% allocation offshore. The Africa specific limit was removed. Despite this regulatory change, data reveals that most funds have yet to fully exploit the increased limit. This raises questions about the industry's response and the implications for investors.

Morningstar data from December 2023 indicated that the average offshore allocation among SA Equity General peer category funds stood at a mere 10%, with many of the funds focused exclusively on domestic markets. Even those with notable offshore exposures fell short of the new 45% limit, prompting further investigation into how fund managers are adapting.

Survey process...and results

We conducted a formal survey among South African equity managers, which revealed diverse responses from the 29 participants to the regulatory adjustments. The survey focused on three relevant topics:

Factors influencing the managers' offshore positioning (if applicable) and the reasoning behind the size of shifts.

How managers would change their strategies if ASISA created local only categories.

Managers' strategies on covering the vast number of offshore counters.

Portfolio strategy

Almost half (46%) of participants opted to maintain their existing strategies, while 30% increased offshore allocations, approaching the new limit. The remaining 24% made minor adjustments within a 2-5% range.

While it may come as a surprise that so many equity managers did not increase their offshore allocation, it is important to understand the rationale behind this. Most of the equity managers have mandates that allow them to only invest in the local equity market. The reason they would be limited to the domestic market only is because most of these local-only mandates are used as part of asset class building blocks within specialist multi-asset fund of funds and/or model portfolios.

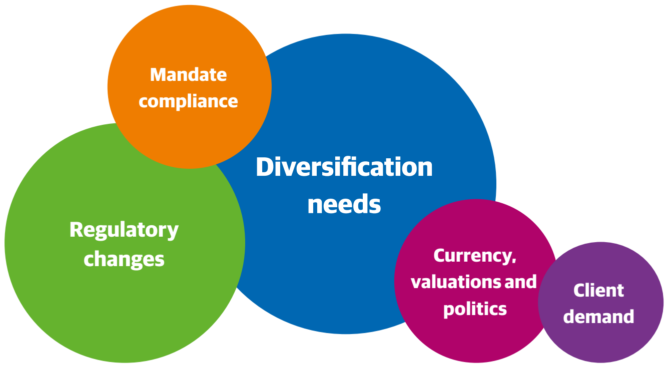
> Mandate influences on portfolio strategy has limited an increase in offshore exposure, on average.

Manager insights

SA equity manager responses to the higher offshore limit (cont.)

Motivations are wide-ranging for those managers that increased their offshore exposure. Global diversification emerged as a main theme, driven by the pursuit of attractive opportunities and risk diversification outside of South Africa. The ability to invest in sectors, industries, and companies that are not available locally – such as major technology firms and luxury brands – appealed to many. Others cited the potential for enhanced risk-adjusted returns and alignment with global market trends.

> Greater offshore investment allows for additional diversification.



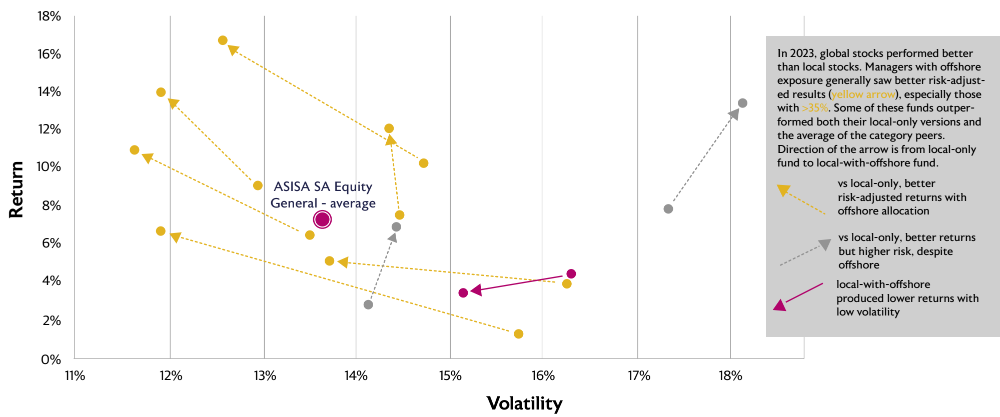
The survey feedback also revealed that local and global economic conditions, valuations, currency, and political scenarios influenced offshore allocation decisions. Some managers saw the regulatory relaxation as an opportunity to align their portfolios more closely with their strategic view of global markets, while others used the opportunity to respond to investor preferences for global exposure.

Offshore diversification in practice

Performance metrics suggest that managers with offshore allocations have outperformed their local-only counterparts over the past two years. For instance, in 2023 the MSCI World Index notably outpaced the Capped SWIX Index by 25.1% in rand terms, underlining the benefits of offshore diversification. While the analysis presented on the chart that follows is dependent on the time frame chosen, generally we would expect diversification benefits from including offshore allocations.

In the risk and return chart below, the local-only funds of managers are linked with their funds that includes offshore. It shows the divergence in 2023 performance from the same asset manager between funds with offshore exposure and their domestically focused counterparts. This highlights how domestic-only funds have generally underperformed funds with global exposure, at higher levels of volatility or risk.

Annualised Nominal Risk-Return Scatterplot - January to December 2023



Source: MorningStar and STANLIB Multi-Manager

Manager insights

SA equity manager responses to the higher offshore limit (cont.)

Potential categorisation changes

The survey also explored potential categorisation changes within the industry. In a paper published for the Actuarial Society of South Africa, Joao Frasco, our Chief Investment Officer, delved into the current ASISA standard for classifying regulated Collective Investment Scheme (CIS) portfolios. His analysis examined the existing framework and suggested improvements in the categorisation to make CISs more easily comparable for advisers, clients, and investors. One of the recommendations from the paper was the splitting of certain categories into two categories, namely local-only CISs and CISs with both local and global assets.

> Local-only CISs and local with global CISs are advisable.

Some managers supported the idea of distinct categorisations for funds based on their geographic focus, anticipating clearer distinctions between local-only and global allocations.

- Approximately 40% of managers positioned themselves in the 'local only' category.
- 20% identified as 'local with offshore'.
- Others, particularly larger asset managers, planned to offer funds in both categories.

We highlight that managers are cautious on launching new funds given the saturation of funds in the South African market. Uncertainty regarding benchmark impacts and concerns about the breadth of the South African equity market also influenced viewpoints.

The approach of local managers to offshore coverage

The last section of the survey disclosed how the participants think about offshore coverage and the strategies required to become and/or remain relevant. Some equity managers integrated the offshore analysis into their existing teams. For those equity managers with a global presence the adjustment was rather easy, leveraging complementary skills across teams to cover offshore markets.

In addition, there were some equity managers that opted to outsource the offshore management, whilst some of the smaller managers relied on Exchange Traded Funds (ETFs) and passives to gain offshore exposure.

Looking forward, the ability to invest a larger percentage offshore will require a different mindset – local equity managers are now competing with established global managers that have solid performance track records in offshore markets. The general consensus among the participants is to expect changes to business models with more partnerships, leveraging both global insights and local expertise to meet the evolving needs of clients.

In conclusion

With the large increase in the offshore limit, you may have thought the local equity managers would immediately increase to their offshore allocations. However, this has not been the case, as many equity mandates only allow managers to invest in the local equity market. At the same time, the added diversification benefits resulted in managers upping their offshore exposure.

Yes, the ball game has changed. The opportunity to invest more offshore has not only 'forced' the industry to rethink how to improve the categorisation of CISs, but has also forced equity managers to consider how they remain relevant in an increasingly competitive environment.

Cleo Molepo
STANLIB Multi-Manager: Research Analyst

Practice notes

How you can benefit from a market 'sabbatical'

Key points

- **Emotional biases involve making decisions based on feelings, which may lead to irrational investment decision-making.**
- **Consider simulating a market 'break' to close the behaviour gap between what we *should do* with our money and what we *actually do*.**
- **A market 'break' forces you to stay invested and align your time horizon with your investment objective(s).**

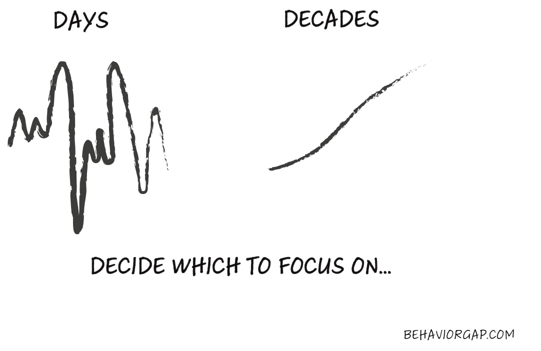
Will we ever learn?

It really has been an extraordinary period for financial markets. Very few people thought 2023 would be a blockbuster year for global equities. They could hardly have been more wrong, not noticing how silly many forecasts seem to be – including my own.

A year ago, everyone was predicting a recession in the world's largest economy. The US Fed raised interest rates at the fastest rate since the 1980s, a regional banking crisis felled Silicon Valley Bank, and war broke out in the Middle East. Yet, shares kept going up and all the major indices are now at new record levels.

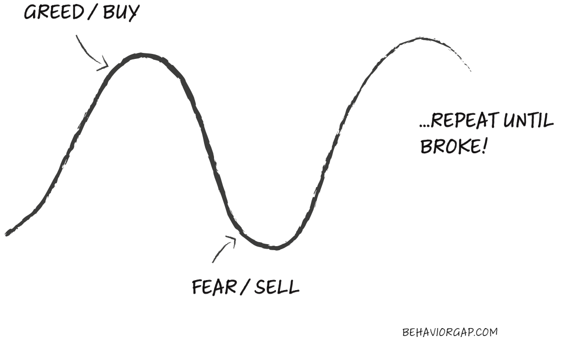
> *I am certainly not going to predict what general business or the stock market are going to do in the next year or two since I don't have the faintest idea. – Warren Buffett*

Investors trying to forecast markets and following daily market headlines often make investment decisions based on emotions and, to their surprise, not achieved the desired outcomes to meet their financial needs.



The greed and fear trap

Whether we like it or not, emotions play – and will always play – a significant role in decision-making, and investors are no exception. At the same time, we need to appreciate that many investors have limited knowledge of financial markets and investing principles. This lack of understanding can make investors susceptible to emotional decision making.



Practice notes

How you can benefit from a market 'sabbatical' (cont.)

Investors often have a short-term perspective for various reasons, such as the desire for quick gains or the need to meet immediate financial obligations. This short-term focus can overshadow long-term goals. Cognitive biases such as fear, greed, and herd mentality can influence investment decisions. For example, fear can lead to panic selling during market downturns, while greed can drive investors to chase short-term gains without considering long-term goals.

Maybe it is time to be bold… 'pull' a Rip Van Winkle

Why not take a 'break' that disengages you from the daily noise of financial markets?

The story of Rip Van Winkle was a 19th-century American classic, written by Washington Irving and published in 1819. It creates an analogy of the American Revolutionary period through the tale of a man who falls asleep and awakes 20-years later to a changed world, having missed the revolution. When you do not watch the market every day, you can finally see with unquestionable clarity that what you would have expected to happen, did not. Rather, the unexpected happened. The gratification comes from never having been remotely tempted to act on any of those forecasts.

Research suggests techniques to take a market 'sabbatical' that can help avoid making decisions you might later regret. It can reduce the anxiety stirred up by negative news. While you 'cannot disappear' for several years, you can pretend that you did. Hal Hershfield, a psychologist at the University of California, Los Angeles and author of [1]"Your Future Self: How to Make Tomorrow Better Today," urges investors to use tools to get away from the domination of the present – envisioning how you will feel about your actions tomorrow can help prevent you from overreacting today.

Honour the mandate

Consider your market 'break' as the time-period you 'signed up for' when you selected a fund/portfolio to meet your investment goal(s).

Different time horizons for different goals

Example: *A fund is expected to deliver real returns of 6% p.a. i.e. CPI+6% p.a. over the long term (net of fees). To minimise the chance of capital loss, investors should expect to invest over periods of at least seven years.*

By understanding and aligning investment decisions with both your investment objective **AND** your time horizon, you can significantly reduce the risk of unexpected outcomes. Understanding your time horizon is crucial because it impacts your risk tolerance. Generally, the longer your time horizon, the more risk you can afford to take. This is because you have a longer period in which to recover from any temporary market fluctuations. On the other hand, if your time horizon is shorter, you may need to prioritise capital preservation over potential gains. Ultimately, understanding and aligning your investment time horizon with your goals is crucial for successful investing.

You may have to be Rip Van Winkel for seven years

Even if the time horizon is longer than say seven years, there is still the chance that the investment may not deliver according to expectations, or it may even make a loss. Therefore, the investment time horizon of a fund should be viewed as the very minimum holding period for an investor. It is important to understand that this is not a guarantee that the investor will not lose money if they hold on to the investment for that period of time. Rather, the chance of not losing money gets progressively better the longer an investor remains invested.

[1] https://files.consumerfinance.gov/f/documents/cfpb_future-self-tool_2021-05.pdf.

Practice notes

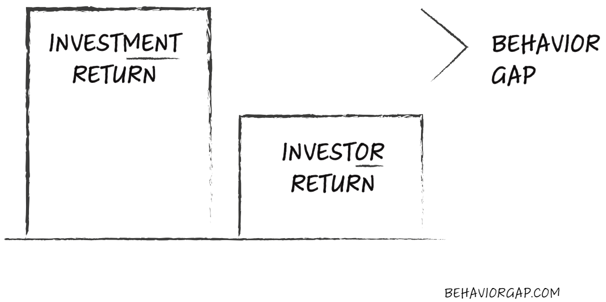
How you can benefit from a market 'sabbatical' (cont.)

Time in the market...not timing the market

Research has also shown that consistently and accurately timing the market is extremely difficult if not impossible. This can lead to missed opportunities and increased transaction costs. It can be tempting to try to buy low and sell high, but the reality is that it is challenging to consistently make accurate predictions about short-term market movements.

On the other hand, understanding your investment horizon also focuses on the need to 'stay invested'. Staying invested – time in the market – helps to reduce the impact of short-term market volatility and allows investments to grow and benefit from compounding returns. By giving your investments time to grow and weather market fluctuations, you are more likely to achieve your financial goals.

There is plenty of evidence that actual returns are far below what the markets deliver. The main reason is that too often people do not hold their investments for the long term. So the shortest, simplest advice we can give is to be patient – stick with your plan/the mandate you signed up for.



The outside perspective

Seeking investment advice can also provide a valuable outside perspective that could help avoid making biased decisions – either by reminding you of your goals, risk profile and strategy; or by providing the information required to make more informed decisions and prevent costly mistakes.

Your financial adviser is there to provide objective guidance and help investors navigate through emotional biases. Advisers offer a rational/unbiased perspective and provide accountability to ensure investors stay focused on their investment goals i.e. allocate money towards investments that are aligned with your investment objective(s) **AND** time horizon(s).

In summary

Let us be honest, it is not easy to take the emotion out of investing. By stepping back – taking a sabbatical – you can reduce the frequency of monitoring markets and avoid being influenced by the day-to-day noise, thereby allowing you to focus on the bigger picture. This can help you maintain a more disciplined and rational approach to investing. It allows you to focus on the fundamentals of your investment strategy and stay committed to your long-term plan.

Albert Louw CFP®
STANLIB Multi-Manager: Practice Manager

Illustrations: Carl Richards

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