Seed Weekly

Investment Complexity by Tawanda Mushore

seed investments

Part 2 - Long Term Investing

Last week we explored how specifically targeting fees and performance can have unintended consequences, leading to sub-optimal experiences for clients (click to read Investment Complexity Part 1). In this article, we explore how to approach long-term investing, making it more manageable for clients.

Consistent long-term outperformance greatly improves the chances of clients meeting their investment objectives. This explains why investors look at performance rankings to select the outperformers. Considering 5 years to be a reasonable period to evaluate South African Multi-Asset High Equity funds, it should follow that top quartile funds (Top 25%) are consistent outperformers.

Table 1 (below) compares the change in fund quartile rankings between a year ago and the end of May 2021. You would not expect too much change, given 5 years is sufficiently long, but there has been significant movement. Of the 2020 top quartile funds, 53% maintained their ranking, while 20% dropped to the second quartile. Potentially concerning for a client who may have invested a year ago, by purely going with rankings is 27% of the funds that have dropped into the bottom half, particularly the 10% that went from the top to bottom quartile.

Table 1: Quartile Ranking Migration of South African Multi-Asset High Equity Fund 5 Year Returns

		Quartile Rank 1 Year Ago (31/05/2020)			
		1	2	3	4
Quartile Rank 1 Year Later (31/05/2021)	1	**53%**	36%	14%	0%
	2	20%	**29%**	34%	7%
	3	17%	29%	**34%**	32%
	4	10%	7%	17%	**61%**

Source: Seed Investments, Morningstar Direct (31 May 2021)

In as much as a fund may have been chosen at the top of the rankings a year ago, the temptation is to switch out of the fund into current winners after a year of underperformance. However, this investor behaviour has generally been shown to be value destructive. A drop in rankings does not necessarily mean the fund is a bad fund, as performance is cyclical. Cyclicality causes unease in the journey, which leads to value destructive investor behaviour. The following considerations are useful for advisors when dealing with long-term investments to deter such behaviour.

"Wealth isn't primarily determined by investment performance, but by investor behaviour." Nick Murray

Do the work

The first and most important thing is carrying out the due diligence work to ensure clients are in the right products, that will deliver on their objectives over the required amount of time. An ongoing assessment is also necessary.

Alignment

Backed by the work, belief in the product should extend to the client. It is tempting for clients to run at the first sign of trouble if the following things have not been communicated well enough :

- How investing works
- Details of the strategy
- When the strategy outperforms or underperforms
- What to expect over time
- How to deal with volatility and cyclicality

To enjoy investment benefits long-term, clients need to stay invested. In the right product, with the right information communicated and belief, there is an incentive to stay invested.

"I've called you in here to keep you in the loop, as we've made some very long-term investments."

Source: Royston Robertson on http://www.roystonrobertson.co.uk/trade.htm (Accessed 11 June 2021)

It is also important to understand that the long-term is a collection of short terms, and thus an unpredictable and volatile short-term is inevitable. Investing long-term does not mean exemption from short-term pain. Awareness is key so that long-term thinking is not a deceptive safety blanket.

Patience

Patience is critical to quality, and continuous due diligence work is required on investments to get a reasonable level of comfort. However, it should not be confused with stubbornness, which occurs when one is wrong but does not want to change their mind. It is worth evaluating whether you are being patient or stubborn. Knowing what would change your mind on the investment, mostly qualitative factors, helps in practising patience. It is not enough to focus purely on performance.

Investor Behaviour and Flexibility

It is not easy to know how you will react in a market correction because of changing environments. One may assume they would be hunting for opportunities but end up chasing survival in the moment. Patience and endurance are tested. Awareness and preparation for this is key. Where possible, it helps to think flexibly about a long-term horizon, that is, as an indefinite period rather than a fixed one. The impact of shocks is more pronounced and likely to influence behaviour when focusing on distinct periods. To enjoy the timeless benefits of compounding, not having restrictive end dates can lessen worries about what happens next in the market. This is not easy given how we think about investments.

The fact that long-term investing is harder than imagined makes it more lucrative than assumed. Doing the work beforehand and ongoing, ensuring alignment with clients, and having awareness of behavioural aspects are useful in managing this journey. Seed provides tools for advisors to tackle this journey for a more comfortable client experience.

Kind regards,

Tawanda Mushore *CFA, FRM*
Head of Research

DISCLAIMER

Seed Investment Consultants is an Authorised Financial Services Provider in terms of the Financial Advisory and Intermediary Services Act (Act No. 37 of 2002). The laws of the Republic of South Africa shall govern any claim relating to or arising from the contents of this document. This document may not be amended, reproduced, distributed or published without the prior consent of Seed Investment Consultants.

No guarantee is provided as to the values of any financial product mentioned in this document. All illustrations, forecasts, information and opinions provided within this document are of a general nature and are not intended to address the circumstances of any particular individual or entity. This document does not constitute a solicitation, invitation or investment recommendation. While we endeavour to provide accurate and timely information, all illustrations, forecasts or hypothetical data are not guaranteed and are provided for illustrative purposes only. We make no representation or warranty, expressed or implied with respect to the correctness, accuracy or completeness of the illustrations, forecasts, information or opinions. No party should act upon such information or opinion without obtaining the appropriate professional and specialised financial, legal and tax advice based upon a thorough examination of their particular situation. Seed Investment Consultants will not be held liable for any direct or consequential loss or damage suffered by any party as a result of that party acting on or failing to act on the basis of information or opinion provided by or omitted from this document.

The value of financial products can increase as well as decrease over time depending on the value of the underlying securities and market conditions. Changes in exchange rates may have an adverse effect on the value price or income of any product.

Past performance is not necessarily a guide to future performance. Performance has been calculated using net NAV to NAV numbers with income reinvested. The performance for each period shown reflects the return for investors who have been fully invested for that period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestments and dividend withholding tax. Full performance calculations are available from the manager upon request.

Prescient Management Company (RF) (Pty) Ltd are registered and approved under the Collective Investment Schemes Control Act (No.45 of 2002). Collective Investment Schemes in Securities (CIS) should be considered as medium to long-term investments. There is no guarantee in respect of capital or returns in a portfolio. CIS's are traded at the ruling price and can engage in scrip lending and borrowing. The CIS may borrow up to 10% of the market value of the portfolio to bridge insufficient liquidity. A CIS may be closed to new investors in order for it to be managed more efficiently in accordance with its mandate. CIS prices are calculated on a net asset basis, which is the total value of all the assets in the portfolio including any income accruals and less any permissible deductions (brokerage, STT, VAT, auditor's fees, bank charges, trustee and custodian fees and the annual management fee) from the portfolio divided by the number of participatory interests (units) in issue. Forward pricing is used. In the event that specific CIS in securities are mentioned please refer to the relevant Minimum Disclosure Document in order to obtain all the necessary information in regard to that unit trust. In rare instances redemption transactions may be subject to a redemption fee. The applicable Prospectus and Key Investor Information Document will be made available upon request.

Please note that there are stipulated cut-off times for all documents, notifications of deposit, investment, redemption and switch applications. These cut-off times are product or fund specific and the applicable guidelines have been stipulated on the relevant supporting or transaction documents, application forms and Minimum Disclosure Documents. Where all required and supporting documentation is not received before the stated cut off time no service provider shall not be obliged to transact at the net asset value price as agreed to. Prices are published daily and are available on the Prescient website at www.prescient.co.za.

Investors should at all times remain aware of the risks involved in the buying or selling of any financial product. Where foreign securities are included in a portfolio there may be potential constraints on liquidity and the repatriation of funds, macroeconomic risks, political risks, foreign exchange risks, tax risks, settlement risks, and potential limitations on the availability of market information. The investor hereby acknowledges the inherent risk associated with any selected investments and that there are no guarantees (Paragraph 6(2)(f) of BN92). The Manager retains full legal responsibility for any third-party named portfolio (Paragraph 6(1)(g) of BN92).

For any additional information please visit our website on **www.seedinvestments.co.za.**