Seed Weekly

Consume Less but Consume Intelligently

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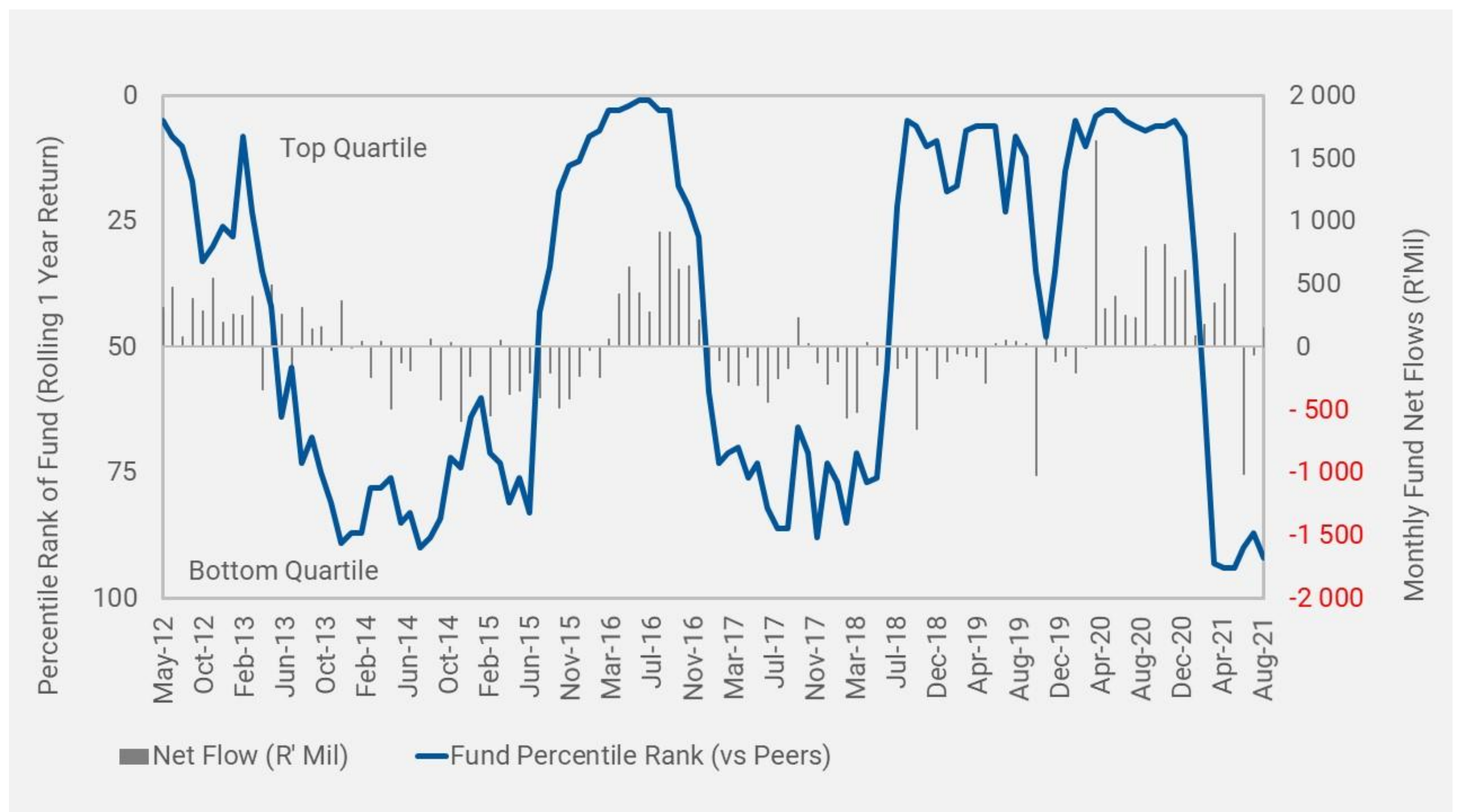
We require enough information to make the right decisions. However, too much information can hinder decision-making.

In his book, Antifragile, Nassim Taleb called it the "noise bottleneck". This refers to the increased noise (irrelevant information) relative to the signal (relevant information) expected to be gained, when one consumes more data, with increasing frequency. In the case of a high noise-to-signal ratio, more information may leave you worse off, less knowledgeable of your surroundings, and lead to sub-optimal decisions. Considering this, it makes sense to consume less information, while making sure you consume intelligently.

The constant barrage of information makes investments complicated for advisors and clients. It is especially difficult for long-term investors with vast amounts of short-term data, which is tempting to act on. Short-term performance data, as illustrated in **Chart 1** (below), is information that investors react to. Investors in Fund 1 (a South African Multi-Asset High Equity of which a reasonable investment time horizon is 5 years or more) react to the short-term relative performance of the fund as shown by the net flows, in-and-out of the fund. For example, the fund mostly experiences net inflows when 1-year returns rank in the top quartile and net outflows when the returns rank is in the bottom half relative to peers.

Chart 1: Fund Net Flows Follow Short-Term Returns (Rolling 1 Year Return Percentile Rank vs Monthly Fund Flows)



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Where patient long-term investing is necessary, reacting to short-term performance is normally not value additive. **Table 1** (below) shows 2 funds with good long-term track records, but with different characteristics and different return profiles (i.e. outperform at different times). The analysis assumes the investor is heavily influenced by 1-year performance and rebalances between the 2 funds every 12 months in favour of the fund with the best return over the previous year.

Table 1: Switching Between 2 Funds in the Same Category Based on 1-Year Term Performance

	10 Years ago (31/08/2011)		as at 31/08/2021	
	1 Year	10 Year	1 Year	10 Year
Fund 1	13.2%	16.8%	9.9%	10.6%
Fund 2	11.8%	16.4%	21.4%	10.9%
Rebalance to Best Performer Last Year			9.9%	10.3%
Rebalance to Worst Performer Last Year			21.4%	11.5%

Given the long-term history of the funds, investors are well served staying invested over the long-term. Rebalancing yearly in favour of the fund with momentum in performance (i.e. the 1-year top performer) does not improve the investor's return over the 10-year period. Switching to the previous year's underperformer yielded the best result. The 11.5% difference in 1-year return at the end of August 2021 is why investors are tempted to switch funds. However, performance goes through cycles and underperformers becoming outperformers and vice versa.

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At Seed, we recognise such complexities in investments given the vast amounts of information available. We simplify complexity for advisors and clients, reducing noise and making it easier to make good investment decisions. Creating financial freedom for clients defines our existence and through our holistic value offering, we provide advisors with tools to deliver on clients' objectives.

Solutions including Seed's multi-managed funds, which allow for fund changes without triggering Capital Gains Tax (CGT) events, and a wider Short List of selected funds, provide good options to deliver on client investment objectives.

Our extensive work and holistic value offering allow advisors to consume information more intelligently for better client outcomes. Partner with Seed for a fruitful investment journey.

Kind regards,

Tawanda Mushore *CFA, FRM*
Head of Research

Sources : Seed Research, Morningstar Direct (31 August 2021)

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