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HOW TO ACHIEVE ABOVE-AVERAGE INVESTMENT RETURNS OVER THE NEXT DECADE

After more than a decade of above-trend market performance, many developed markets have started a process of mean reversion. Many leading global banks and asset managers believe that the average annual share performance among companies in the United States (US) will only be 5% in USD over the next decade. This is far less than the above 20% annual growth that we often saw over the past decade.

We agree with the view of many experts that US equities should outperform their European counterparts simply because of the underlying philosophy of European policy. For one, the Americans can use the blunt tools of monetary policy much more effectively than the single-currency block can. The Americans are also much more brutal when it comes to the efficient allocation of scarce resources. Conversely, the Europeans would rather keep a less efficient capital allocation system alive, whether that be by government's hand or the private sector, than cause their citizens some temporary discomfort.

The shift back towards the long-term mean (read average) equity market performance was, of course, brought about by the structural shift in monetary policy. After reaching lows not seen for more than a millennium, interest rates in the leading global economies have made an abrupt U-turn, shaking the very fabric of investor sentiment. While loose monetary policy made equity investing easy, the return to what many believe is normal, is causing a lot of confusion among investors. Now, bonds, among others, are starting to look more attractive. More choices on top of all of the market uncertainty caused investors to become startled and to reconsider their asset-allocation decisions. But over the last couple of weeks, it seems as though investors have slowly started to regain their confidence, realising that the long-term story that favours equity has not changed, and that volatility simply allows for good buying opportunities.

It is important to understand that lower average equity returns do not mean that some companies will not continue to deliver returns far greater than 5%. It only means that, now, more than ever, active management is of the utmost importance. It means that simply buying a passive instrument that tracks the market, overweighted by the largest, mostly US technology companies, which benefit most from historically-low interest rates and yield-curve control, will not be sufficient to generate above-average returns. To achieve above-average returns in the next decade, investors need the correct structures and exposure to the correct asset classes. Please note that I purposefully do not mention fees. That is because retail investors in South Africa (SA) have an unhealthy appetite for lower fees, which will, undoubtedly, lead to unwanted outcomes in the future. Fees are well-regulated to protect investors in SA who partner with reputable and regulated partners. But driving fees ever lower distorts the market's ability to effectively price and to allocate resources by leading to foreclosures, cutbacks, layoffs, and even sector consolidations.

How you structure your investments will become of the utmost importance in the next decade. That is, in which legal entity and in which tax jurisdiction you own assets. Clever investors, who structure their assets in the most tax-efficient manner, will be the clear winners. After effectively structuring assets, asset-allocation decisions will become increasingly important over the next decade. For one, it will become increasingly important to invest in alternatives, such as private equity and hedge funds. It will also become increasingly important to consider certain long-term thematic investment themes, such as investing in water and investing in a more socially-responsible way. It will likewise become increasingly important to consider in which geographies you invest. Unlike the decline, that is, the return to normal, we are starting to see in the developed world, many of the emerging countries (including SA) who struggled over the past decade, are slowly starting to re-emerge, offering very attractive returns.

Unfortunately, by not structuring their estates effectively and by not investing in the correct assets, most retail investors, especially those who have been scared out of markets over the last year, will miss out on what could be above-average performance over the next decade.

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