EFFICIENT GROUP

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HOW DO THE RICH GET RICHER? THEY STAY INVESTED AND BUY MORE!

During the last couple of months, we have partnered with many financial advisors, doing our utmost best, to keep investors calm during this period of extreme volatility. It has not been an easy task. Since the last quarter of 2018, global markets have seen three major disruptions. In 2018, indices such as the S&P 500 contracted by more than 15% during the last quarter. In 2020, when the reality of the COVID-19 pandemic first hit global markets, we saw a contraction of almost 30%. If that was not enough, less than two years later, global monetary policy tightened up and Russia invaded Ukraine, sending markets down again almost 30%. But this is not the end of the story for South African investors. Most South Africans have the bulk of their equity invested in the local market, which has been performing poorly for many more years. As a result, investors have grown tired of equities, leading some to make poor asset-allocation decisions at the worst possible time.

Research is clear: Even after all of the upset and disappointment that we have seen in equity markets during the last couple of years, equities still outperform other asset classes in the long term, especially if we consider inflation, costs, and taxes. In one extreme case, a client invested offshore at the end of 2018. Spanning this four-year period, the client's portfolio contracted by more than 22% in United States (US) dollars. But the client lives in South Africa (SA) and will eventually retire and draw an income from their investment in SA. So, this client should not only consider the US dollar return but their actual buying power, that is, the SA rand return, which is up by 8%. Of course, an annual return of 2% does not cover inflation and costs but viewing these four years of unrealistically low returns in isolation is also incorrect. Even clients who are close to retiring should consider these past four years in the context of their contributions across their entire lifetime. Clients who are still saving towards retirement should consider their entire investment lifetime. In this context, it is easier to remember why they should remain invested in equities even if this particular investment lifecycle takes longer than five years to see the type of returns that will, once again, outperform other asset classes. Research is also clear that investors usually make the wrong re-allocation decisions, that is, moving from one asset class to another, at the worst possible time. Retail investors have a nasty habit of selling out of their equity positions after the market crashes, only to buy back in once the market reaches new highs.

What clients should rather do is to use volatility as buying opportunities. One farmer explained it like this: "Each market crash is like a drought. During a drought, my cattle lose a lot of weight but I still have the same number of cattle. Instead of selling my cattle and realising my losses, I try to buy my neighbours' cattle!". This is exactly what private equity (PE) firms are doing, even in SA. Since 2018, more than 20 firms have delisted each year from the Johannesburg Stock Exchange. Many of these firms were purchased by PE firms, who simply could not resist the attractive valuations. So, while retail investors are switching out of their equity positions (selling their skinny cattle), institutions are buying up everything (their neighbours' cattle). The reason institutions do this is because they are less emotional, they understand the long-term value and benefits of equities, and they know that time in the market is what matters most. While many retail investors tired after four to six years of unexpected low returns, institutions did not. While retail investors got emotional and sold out of their long-term convictions, institutions did not. And this is how the rich get richer.

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