EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR MONTHLY ECONOMIC UPDATE

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RECENCY BIAS AND HOW 2022 AFFECTED INVESTORS

Finally, we come to the end of another volatile year that tested the best of us. Since the latter parts of 2018, global markets have not been kind towards investors. Markets fell by roughly 15% in the final stretches of 2018, then recovered, and then the COVID-19 pandemic in 2020 beat down the markets by more than 30%. After governments stepped in with substantial fiscal and monetary support, which ballooned debt and overstimulated demand even more, the recovery was quick. Until 2022 came along. This time it was the historic shift in monetary policy that beat markets down. Unfortunately, 2018 is about as far back as investors remember. In this specific application of the recency bias it causes investors to make the wrong long-term asset allocation decisions because the short-term volatility we experienced since 2018 gets the best of their emotions. In the end, their long-term investment performance suffers.

In South Africa, interest rates have doubled from 3.5% in November 2021 to 7.0% at the end of 2022. This means that every R1 million debt that a household has, is now R35 000 more expensive each year. That means almost R2 920 extra expenses each month, an almost unbearable load for consumers who are already stretched thin. In the United States (US), the Federal Reserve (Fed), increased rates at a similarly historic pace. US consumers were fattened by plenty of government support and more than a decade of overperforming equity markets and other asset classes, and have, therefore, gone through their interest rate hiking cycle almost unscathed; albeit for now. Nevertheless, this historic shift in monetary policy shook the very fabric of markets as asset class returns and investor sentiment started to normalise. At one point in time, global markets were again down by roughly 30%. But year-to-date the MSCI All Country World Index, an index that represents most of the largest companies in the developed world, is only down -13.25% in USD (or -10.98% in ZAR). Closer to home, the Johannesburg Stock Exchange All Share Index (JSE ALSI), an index of all listed companies on the JSE, was up by 1.52%, outperforming global markets simply because it has been underperforming for many years.

Unfortunately, investors are plagued by recency bias; most of us cannot even remember what we did a few weeks ago, how can we be expected to remember how different asset classes performed over the last 15 plus years? Biases like recency bias and loss aversion also cause us to interpret reality incorrectly, making it almost impossible to objectively, and therefore accurately, allocate assets for the next 15 plus years. This causes investors to become emotional and short-sighted and end up selling out of good long-term strategies. Even the new favourite, structured products, have not stood the test of time and we have seen many clients who were upset with the decision they made to allocate an overweight position to structured products. As an example, many investors who piled into various Eurostoxx structured products, the favourite of 5-10 years ago, lost out considerably as inflation and costs ate into their capital, which was at least secure. But that is not the worst of it... You must also consider the opportunity cost of getting your money back after 5 years and having missed out on the returns of alternatives; even the JSE ALSI outperformed many of these structured products. However, history is clear that after tax, inflation, and costs no other asset class in the traditional financial sector outperforms equities. History is also clear that trying to time the market rarely ever works out well for investors. Research is also clear that the objective and holistic assistance of reputable financial advisors and asset managers adds substantial value to investors in the long-term.

Where does that leave us for 2023? At the end of 2021, we advised our clients to prepare for steep interest rate increases. Those who listened are in a much better position now. We recommend that individuals should not allow short-term volatility to change their long-term asset allocation decisions; even in a worst-case scenario where a president might have to step down. Do not be too hasty in making decisions. Seek objective truths, and always speak to your independent financial advisor so they can help you to develop a holistic, multi-generational financial plan. With a clear objective, a time-horizon that stretches over generations, and an objective, independent analysis, you can allocate resources much more efficiently in the long-term and create the wealth you and your family deserve.