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INVESTMENTS

VALUE OF ADVICE IN UNCERTAIN MARKETS

JULY 2018

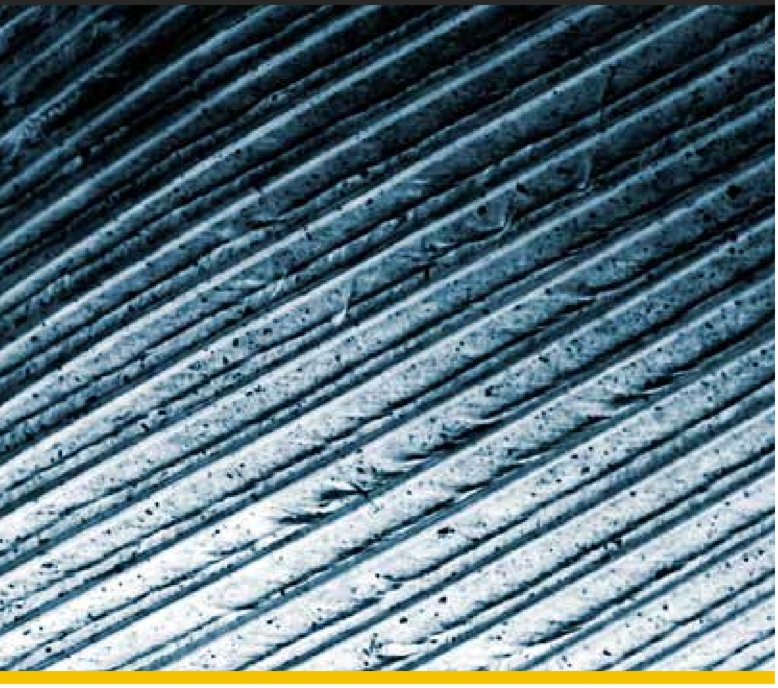
YOUR FUTURE
OUR PASSION

A story about Steve

It's a question that financial advisers so often have to answer during times of market turmoil: "When is the right time to move into cash?" The short answer: "Never". [1]

During the 2017 edition of the Celerity Investments roadshow we told the story about Joe the American investor, who was the world's worst market timer and invested in the S&P500 before each one of the large market crashes during the past 40 years. Over this period his investment still beat the US stock market by more than 4% per annum, even though he could not time his purchases any worse.

Since then, we have come across Steve, his younger South African counterpart.



STEP 1:
Saving for retirement

Steve is South Africa's worst market timer, and like so many other investors it takes Steve a long time to build up enough trust to invest his hard-earned savings. What follows is Steve's tale of terrible timing of his stock purchases.

Steve lives in South Africa and began his career in 1980 at age 23. His first job paid him a salary of R12 500 per year – around R312 000 in today's money. Steve was a diligent saver and planner. His plan was to save 10% of his salary every year. This means that his contribution increased at the same rate as his annual salary increase throughout his career. Steve turned 61 earlier this year and is now approaching retirement.

Steve did not trust his financial planner's advice by regularly investing in the market, and rather kept his money in a bank account where it earned interest. He reasoned that he'll put it into the market when it feels like the right time. Steve's problem was that he only had the courage to put his money to work in the market after a huge run up. So every time he invested, all of his money went into a combination of three equity funds managed by the large life insurance firms[2]. He made his first investment (just over R1 000) ten months after he started working, as the SA equities market had been running hard in the four years while Steve was studying. From October 1980 the South African Stock Exchange dropped close to 38% in the next two years so Steve basically put his first contribution to his retirement savings in at the peak of the market right before a crash.

Yet he did have one saving grace. Once he was in the market, he never disinvested. With the help of his financial planner he held on for dear life because he was too nervous about being wrong on his sell decisions too.

Remember this decision because it's a big one.

Steve didn't feel comfortable about investing again until August 1987 after another huge bull market. After six years of saving he had another R15 000 to put to work. Again he put it in three funds and again he invested at a market peak just before a crash.

This time the market lost more than 40% in less than six months (following Black Monday (19 October 1987) when the Dow Jones Industrial Index lost 23% in a day) right after Steve made his investments. Timing wasn't on Steve's side so he continued to keep his money invested as he had before. It was, sadly for Steve, only in 1998 that he had enough courage to move money from his savings account (this time close to R74 000) into his investment in the JSE. History shows that the SA stock market had a downturn of nearly 40% in just four months in this year.

This buy decision left Steve with more scars but he decided to make one more big purchase with his savings before he retired. The final investment was made in October of 2007 when he invested R134 000 which he had been saving since 1998. He rounded out his string of horrific market timing calls by buying right before what is now known as the Global Financial Crisis (GFC).

After the financial crisis he decided to continue saving his money in the bank (another R220 000) but kept his stock investments in the market until the end of 2016.

To recap, Steve was a terrible market timer with his only stock market purchases being made at the market peaks just before extreme losses.

Here are the purchase dates, the market crashes that followed and the amount invested at each date:

Date of Investment	Subsequent Crash	Amount Invested
October 1980	39%	R1 000
August 1987	43%	R14 800
April 1998	40%	R73 700
October 2007	40%	R133 900
Not yet	-	R220 000
Total savings		R443 400

Luckily, while Steve couldn't time his buys, he never sold out of the market even once. He didn't sell after the bear markets of the early eighties, Black Monday in 1987 or the emerging market crisis and technology bust in the late nineties or even the financial crisis of 2007-09.

Following the advice of his financial planner (at least this part of it) he never redeemed any portion of his investment. So how did he do?

Even though he only bought at the very top of the market, Steve still ended up a millionaire with R1.7 million. This is a return that comfortably beat South African inflation over this period (which was on average 9.3% per annum), so his savings retained its purchasing power. It sounds almost too good to be true, but here's the explanation:

First, Steve was a committed saver and planned his savings in advance. He never wavered on his savings goals and increased the amount he saved over time.

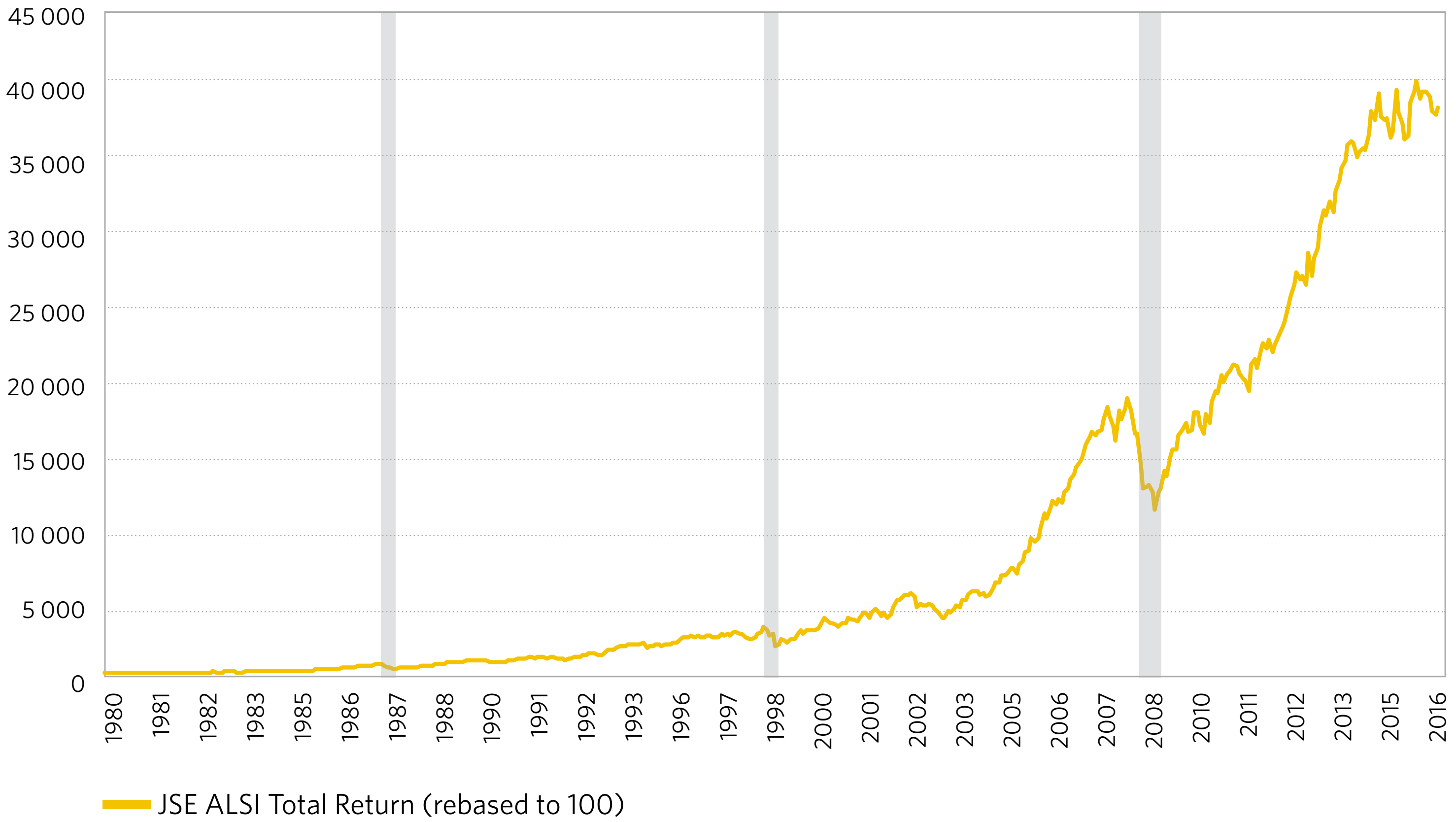
Second, he allowed his investments to compound over the decades by never selling out of the market over his more than 40 years of investing. He gave himself a really long runway.

He did have to endure a huge psychological toll from seeing large losses and sticking with his long-term mindset, but with the encouragement of his financial planner Steve didn't pay much attention to his portfolio statements over the years. He just continued to save and kept his head down.

He had a very simple and sensibly priced investment plan — one strategy (growth assets in the form of South African equities) that was appropriate given his very long-term investment horizon.

Finally, he got himself a financial coach, who knew the benefit of remaining invested in the market.

4 BEAR MARKETS (1980 - 2016)



STEP 2:
Drawing income from retirement funds

The astute investor may argue that it's all good and well to take a lot of risk while in the process of building up capital ahead of retirement, but once you start drawing income from your investment you should focus much more on protecting the downside.

According to Pieter Hugo, Managing Director of Prudential Unit Trusts, this is indeed one of the tools that an investor should use to protect their hard-earned retirement savings. He however argues that this should not be done at the cost of losing purchasing power over the longer term. In short: retain enough growth assets (equities and property, both local and offshore) in your portfolio, but balance it with defensive assets (bonds and cash) to limit the downside when markets pull back. This is where advice from a trusted financial planner becomes invaluable – they'll guide you into the right mix of assets that suit your risk profile.

In addition to managing drawdown risk, Hugo also argues that your investment manager would be tilting the odds in your favour by tactically shifting your portfolio to asset classes which are relatively cheap. In practice this, for instance, means buying more equities when they've been through a difficult period, and selling bonds after a strong rally. It doesn't always "feel" right, but as Warren Buffett once said: "investing is simple, but not easy".

The third piece of advice from Hugo is that investors should pick a strategy and stick to it. Various studies show that investors typically follow performance – they invest in funds after they've had a period of outperformance and disinvest from funds after periods of underperformance. In this way investor behaviour typically reduces their portfolio performance by around 3% per annum – far more than the impact of any fees on the investment. It's in times of market turmoil that investors should sit on their hands rather than make changes to their strategy. It seems counterintuitive, but it's been proven the sensible approach over many decades. If you can't help yourself tinkering with your portfolio then pay someone to protect you from your own harmful behaviour – it's worth every cent.

In conclusion

Give yourself a long runway.
Find a trusted adviser to protect you from yourself.
Stick to your investment strategy.

One day you'll look back and realise that you're not Steve.
And you'll live happily ever after....

Footnote:

[1] There is a caveat though: if an investor does not have a requirement to retain the purchasing power of their capital and can't stomach any losses, cash may be a useful parking bay. There are however not many such investors around.

[2] We've used three equity funds with long track records: Sanlam, Stanlib (Liberty originally) and Old Mutual, and assumed a fee of 1.00% per annum to the financial planner.

This story is for illustrative purposes only and is not a recommendation for a portfolio consisting of 100% of stocks in a single market (such as the JSE All Share Index) unless you have an extremely high risk tolerance. Even then a more balanced portfolio in different global markets with a sound rebalancing policy makes much more sense.

If Steve followed all of his financial planner's advice and simply Rand cost averaged into the market on a monthly basis with his savings he would have ended up with much more money in the end (over R4 million, more than 5% per annum ahead of inflation). The additional R2.3 million rand in savings makes the financial planner's fee pale in comparison.

But then he wouldn't be 'Steve, South Africa's Worst Market Timer'.