Focus on what you do know

A few reminders when it comes to investing

Morningstar Investment Management South Africa

October 2022

Debra Slabber
Portfolio Specialist
Morningstar Investment Management
South Africa

For Financial Advisors and their Clients

Year to date investors have been fleeing from risk assets due to a confluence of intertwining factors. This includes very hawkish central banks globally trying to fight persistently high inflation, a softer global growth outlook, the war in Ukraine and further supply shocks (just to name a few). It is understandable that some investors are feeling fearful and defeated by the current market volatility and muted returns.

When very persistent negative narratives are so visible, it becomes very difficult for investors to focus on anything else. We become obsessed with the things we don't know and how markets will play out over the short term, and we lose sight of the things we do know.

When it comes to investing, what do we know?

1. Crisis brings about opportunity

In the words of John F. Kennedy: "The word 'crisis' is composed of two characters—one represents danger and one represents opportunity."

There is no doubt that change usually happens because of a crisis. A look back in history quickly reveals numerous ways that crises have offered unexpected benefits for societies, countries, and humanity. The outbreak of Covid-19 accelerated the trend for technology adoption within businesses, World War II paved the way for the birth of the United Nations and Bretton Woods institutions, and the 2008 global financial crisis led to major economies forming the G-20 alliance.

2. The world isn't ending, even if it feels like it. And if the world does end, your portfolio will not matter.

Even when we have crashes, pandemics, recessions, bear markets and geopolitical upheaval the world doesn't actually come to an end. Just as the sun rises and sets daily and the earth keeps on turning, the world continues to operate, even if in an adapted way.

There will always be scary headlines and intelligent-sounding narratives about why the world is coming to an end. If it does, our problems will be much bigger than worrying about what we are invested in.

3. There is always a trade-off

Life is a series of trade-offs, and greater results usually require greater trade-offs. For example – money versus time, family versus work, job security versus job opportunity. The same goes for investing.

Every investment decision you make is simply a trade-off from one risk to another. Risk never completely goes away no matter how hedged you think you are. When you combine risk with an inherently uncertain future, investing is not always that much fun. But, there is always something worth investing in.

The price of admission to the stock market is bone-crushing volatility, a lumpy return stream along with the pain that is brought about when you witness your life savings reducing in value.

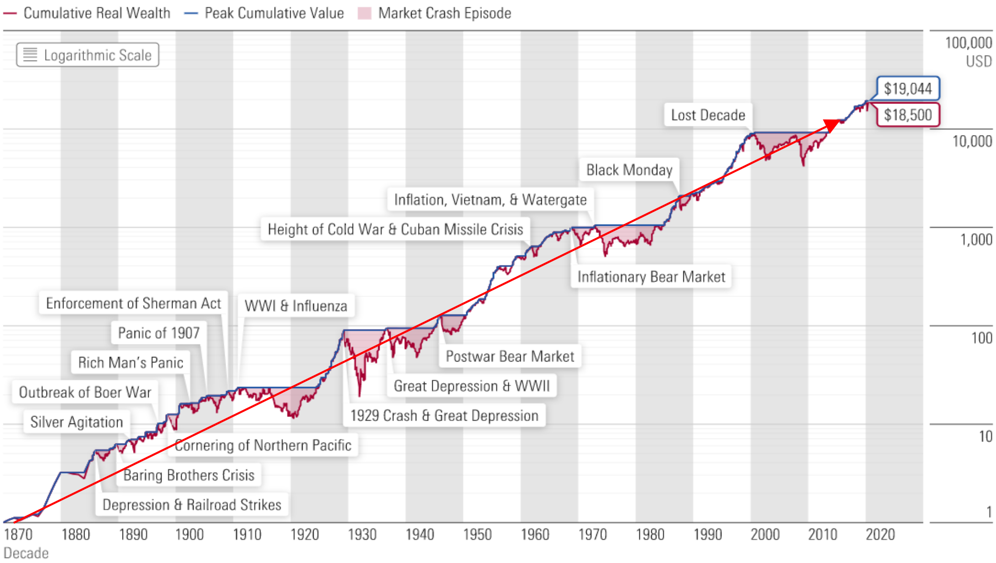
The trade-off (or rather gain) is long-term returns above the rate of inflation, compounding that can earn you multiples of your initial investment and access to the greatest wealth-building machine ever created - the stock market.

4. Over the long term, the market does go up

This is an easy one because long-term data does not lie. Most of the time markets are positive (as per the graph below). Corporations like making profits. Money must go somewhere and people like the returns they get in the stock market. Simple.

But to derive these positive returns, you have to be invested. Unfortunately, that involves staying invested through periods where markets go down. Why? Because no one can accurately and consistently time the market.

Market Crash Timeline: Growth of $1 and the U.S. Stock Market's Real Peak Values



Data as of Jun 30, 2020. Sources: Kaplan et al. (2009); Ibbotson (2020); Morningstar Direct; Goetzmann, Ibbotson, and Peng (2000); Pierce (1982); www.econ.yale.edu/^shiller/data.htm, Ibbotson Associates SBBI US Large-Cap Stock Inflation Adjusted Total Return Extended Index.

5. Forecasting adds little value

It is certainly standard practice in the investment management industry to hypothesize macro forecasts, share them on request, and bet clients' money on them.

It also seems conventional for money managers to trust in forecasts, especially their own. This is risky business. As soon as you realise that you don't have an edge in forecasting macro events or political events your life becomes somewhat easier. In short – forecasting is a fool's game.

Amos Tversky once said, "It's frightening to think that you might not know something, but more frightening to think that, by and large, the world is run by people who have faith that they know exactly what's going on."

In closing - I want to challenge you today to stop worrying about everything that you don't know

But what about inflation, the upcoming election, the duration of the bear market, and interest rates? There will always be an endless amount of questions, but the main answer to all these is that there is no way to know with certainty how any of these factors will impact your investments.

Focus on what you do know. Continue to save and invest independently of what the market is doing. None of us has control over what happens in the market or can accurately predict macroeconomic factors.

What we do have control over is how much we save, how we allocate our assets, how often we check the market value of our portfolios and how we make intelligent investment decisions.

+ t: (0)21 201 4645 + e: MIMSouthAfrica@morningstar.com + 5th Floor, 20 Vineyard Road, Claremont, 7708.