The danger of letting investment vehicles drive your investment journey

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For Financial Advisors and their Clients

High inflation brings with it increased levels of financial stress due to the rising cost of living. During times of high inflation, especially when coupled with the levels of market volatility we are experiencing year-to-date, investors tend to re-examine their finances. This includes relooking their spending, budgets, and investments as well as the effectiveness thereof.

When looking at our budget and ways to maximise our money, it can easily be done by changing to cheaper products or simply cutting out a few luxury items (we also list a few options here). The same, unfortunately, can't be said when it comes to investments. The world of investments is complex, with each of the different products on offer, having a different set of rules, fees and tax implications.

How do I find the right investment product best suited to my needs?

As spending power decreases, our focus on saving costs and searching for cost-effective options increases. It's only natural that we want to get as much bang for our buck as possible. In addition to high inflation, investors are also facing poor market returns in the short term.

Often the first thing investors review are the types of products, or rather investment vehicles, they are invested in. They are left wondering – should I be switching to cash? Should I be considering a different fund? Should I rather look at fixed-term savings and lock in a certain interest rate? Should I be investing in the stock market?

All of the above questions point to investors looking for the same answer – how can they maximise their returns, or at the very least, guarantee a return versus a loss?

We've written about the perils of performance chasing, and how in times of volatile returns investors seek out previous winners and switch their investments to include these performers, hoping for the same or a better outcome as in the past. The short answer is of course that trying to chase performance can be extremely harmful to an investor's returns over the long term. It's rare (if not impossible), even for professionals, to consistently time investment in and out of the market over time.

In the same vein, investors should proceed with caution when changing investment vehicles and products with the main goal of obtaining instant returns.

It all starts with you and what you want your money to do for you

First and foremost, investors need to really drill down and ask themselves what they want to achieve through investing. Before looking at products, there are some essential questions that you need to answer:

- **What is your main investment goal?** Think about what you are saving for. Do you expect your savings to grow for a future pay-out, for example, retirement, a child's education, or to increase your money or leave an inheritance? Or will you use these savings to add to your income immediately?

- **How much time do you have to invest / what is your time horizon?** How long can you leave your funds invested without withdrawing? How long can you keep contributing to your investment/savings?

- **Once you start spending your money, how long do you expect to continue to withdraw funds from your investment portfolio?** Do you want to spend all your money at once, for example, to buy a house? Or do you plan to make the money last over a longer period, for example, by paying yourself a yearly income once you retire?

- **Once you start to spend the money in your investment portfolio, how much do you plan to withdraw?** If your investments are worth R100,000 and you want to withdraw a yearly income of 4%, you will need to take out R4,000 each year.

- **What is your attitude to risk?** Some investments offer the opportunity for a greater gain but with the risk of a greater potential loss. Investing involves a trade-off between risk and returns. Historically, investments with higher returns have been associated with greater risk and chance of loss. Whereas cautious investments that have had a lower chance of loss also have achieved lower returns.

It's important to be aware of the range of possible risks and to pick and choose those that are appropriate to the specific goals, personal situation, and investment puzzle that you may be seeking to solve at any given moment in your investing lifetime.

What to look out for when picking your investment vehicle and/or products

After you have established what you want your money and investments to do for you and answered the above set of questions, this is when you can start looking at what product or vehicle will serve these needs the best. We strongly urge investors to consult their financial adviser at the outset of this journey, who will be best placed to assist with creating a suitable risk profile as well as recommend the different options that are available and best suited to their unique needs.

There are various factors to consider, and each factor will vary in importance depending on the goal of your investment. Generic factors to look at would include (but are not limited to):

- **The type of investment:** In South Africa, you can invest in an array of different investment options.

  Short-term investments typically include cash (savings deposits, call deposits or fixed-term deposits) and short-dated fixed income investments (like money market funds, short-dated bonds, 2 or 3-year retail savings bonds).

  Long-term investments typically include equities (direct stocks, unit trust funds that invest in equities, or exchange-traded funds that invest in equities), property (direct real estate or real estate investment trusts) and long-dated bonds (government, corporate or retail savings bonds with maturity longer than 5 years).

  One also needs to consider whether they require a product wrapper to house their investments, such as a Retirement Annuity, Living Annuity or Endowment.

- **The return earned:** Every investment mentioned above, has its own form of return (interest, dividends, and capital gains) that the investor will earn for investing. This may be a guaranteed amount (which is the case with fixed-term deposits) or a variable amount which is market dependent (as in the case with equities). The intervals in which interest or dividends are paid out may also vary – monthly, quarterly, semi-annually, or annually.

- **Minimum investment amount**: This is the minimum investment amount a fund will accept to establish a new account. For example, some unit trusts require a minimum investment of R500 - R1000.

- **Liquidity:** This refers to the ability to buy or sell an investment quickly and easily without substantially affecting the asset's price. Large volume, blue-chip equities like banks are highly liquid investments. Shares in small companies with low volume activity are not considered liquid. High-level liquidity is considered a good feature for a security or a commodity. Liquidity also refers to the ability of investors to convert investments into cash.

- **Accessibility, withdrawal rates, penalties and timeframes**: Investments all come with their own set of rules and guidelines when it comes to accessing your money. For example, accessing your money in a bank account is instant, it can be withdrawn at any time with no penalties. Most money market funds require at least 24 – 48 hours' notice for the funds to be withdrawn, however, there are no penalties involved.

  In the case of fixed-income investments like fixed deposits and/or RSA Retail bonds, which require a minimum lock-in period of either 2, 3 or 5-year investment periods, you will have to remain invested for the full period, until the investment reaches its maturity date. If you wish to withdraw your investment before the maturity date, you could incur hefty penalties.

- **Diversification:** The basic concept of portfolio diversification is spreading your money among a variety of different investments in an effort to improve your risk-adjusted returns.

- **Tax:** Tax is an important consideration. For example, will the return you earn on your investment be included in your annual income tax amount, and taxed at your marginal tax rate, or is the income earned free of tax? Other taxes to consider include capital gains tax, interest exemptions, dividends tax, and transfer duty.

- **Upon Death:** It is important to consider what will happen to your investment upon death. Some investments will allow you to nominate beneficiaries, whereas others do not. Unless otherwise structured, a typical investment will pay out to the estate account upon death and will be subject to estate duty tax and executor's fees.

The best thing an investor can do when contemplating change is to reflect on their goals

Ask yourself this: "Given where I am now, what actions move me closer to my long-term goals?" "Would an investment change align with the original investment plan for reaching well-defined goals?" These are different questions than, "What do I wish I had done last month"? No doubt losses are painful. But reactivity to losses can induce a person to act rashly and make things worse in the long run.

So, the key question to ask is whether anything has fundamentally changed since setting the original strategy or whether it's just that you are disappointed with your progress toward your goals.

If something has fundamentally changed, the question to ask is whether you can clearly identify what has changed. Write it down, then balance this by writing what it might mean if you're wrong. This should include any misjudgment risk as well as the added costs if you decided to change investments (given where you are now). You may often find that the impulsive change you desire is not necessarily going to increase the probability of reaching your goals.

If it has "just" disappointed you, but nothing has fundamentally changed, the likely best option is to stay the course. By thinking probabilistically and remembering that investment markets never move in straight lines, you may avoid the perils of trying to time the market.

In closing

As professional, multi-asset investors, we focus on investment objectives, always bearing in mind the opportunity costs and risks. Investing, like many things, often involves taking the thorns with the roses: There is no reward without risk.

Over decades of evidence and through the investment literature there is one golden thread–the evidence clearly favours time in the market over timing the market. It is important to reiterate that investors shouldn't avoid change altogether, however, must be far more calculating when they do make a change.

So, if you catch yourself getting down about the state of the equity market or trying to predict what's next, keep in mind these concepts and always remember why you are investing in the first place.

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