



## Talking Points

### Reflecting on the year that was

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For Financial Advisors and their Clients

**Most investors will be pleased to say goodbye to 2018. It was a year that started with such promise and optimism and ended in a rollercoaster ride leaving South African investors disappointed for the 5th year in a row.**

Just as South Africa sorted out its house (so to speak) at the start of 2018 and re-entered the global investment spectrum, it was global markets that impacted us. The trade wars, the slowing of global growth and rising interest rates that contributed to the rapid unwind of global sentiment and a sharp decline in global markets, including ours. In the fourth quarter of 2018, the majority of global markets fell by more than 10% in the period—in fact, 181 of the 215 equity markets we cover fell by 10% or more (in local-currency terms).

As we reflect on 2018 and try to make sense of the year that had so much promise, the below points may resonate with investors:

- 1) **Doing something:** Since it has been 5 years of low and now negative returns for investors with equity and growth assets, it will feel more comfortable doing something rather than nothing this year. We are starting to sound like a stuck record when we say that sitting on your hands and doing nothing is the best action you can take. Doing something gives one the feeling of control, however, it is precisely the changes we make in times of distress that can lead to long term wealth destruction. No one said being patient is easy; or fun.
- 2) **Regret and envy:** There will always be someone, some fund, some share or some investment strategy that did a lot better than yours (through luck or skill) and you may regret missing out. Fear and panic can force us as investors into making mistakes with our money, but envy is probably more destructive. Let's cast our minds back to 2017 when Bitcoin was all the rage. Fast forward one year and Bitcoin is down over 70% in just 12 months.
- 3) **Overpaying for good news stories:** Market darlings can become overvalued menaces. When there is a correction in their share price, they are likely to impact the broader market too – as we saw with Naspers in 2018 and the Nasdaq in the last quarter of 2018.

So, where does that leave us as we enter the new year? In the short term, it is anyone's guess (we've never proclaimed to have such a crystal ball), however, there are some things that we do know:

- 1) **It's going to be bumpy:** Make no mistake, there will be more bad news, things to worry about and further volatility this year. Should this worry you as an investor? Absolutely not. It's par for the course and it's what sells. I can't think of a year that was full of good news and warm fuzzys. Every year holds unknowns and uncertainties. It's our behaviour that defines our investment outcomes.

- 2) **Value.** By steering clear of the expensive and overhyped areas of the market in 2018, we avoided some of the market pain, yet there was no hiding from the overall market declines. While contagion across all markets is likely should we see continued volatility and drawdowns in the U.S. market, we believe that much of the pain is in the price of SA domestic focused businesses. Looking forward, what matters greatly to us is to not overpay for a stream of long-term cash flows. For a while we have been speaking about the many domestically-focused businesses that remain out of favour due to the persistent gloomy economic outlook in South Africa. With elections around the corner and the possibility of policy reform geared towards the goal of economic growth, we are aware (albeit with a pinch of caution) of any unlock that could potentially materialize from purchasing these assets below fair value.
- 3) **Staying the course:** The envy of missed returns enhances one's own desire to act. The temptation to take control and make a change is real. We appreciate that the current market conditions are both challenging and uncomfortable; it is at these moments that we encourage everyone to stop and pause, using evidence and perspective as their guide. That is, our greatest opportunity to add value comes off the back of disorder and extremes, acting rationally when others won't or can't.
- 4) **Diversification:** While it may feel silly in the short term and not work over certain calendar years, the reality is that diversification does work. Our asset allocation framework provides a tried and tested method for building portfolios that are not reliant on individual market outcomes. Our view is that a diversified portfolio tilted towards asset classes with higher expected returns, within appropriate risk constraints, provides the best chance of reaching our investors' objectives.

Overall, it was a disappointing end to a challenging year. By favouring unloved assets, we avoided some of the biggest drawdowns, yet there was no hiding from the broader market declines. It certainly sets up an interesting period ahead, where risk and opportunity must be carefully balanced.

**Risk Warnings**

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