Jan
2019

FINANCE MATTERS

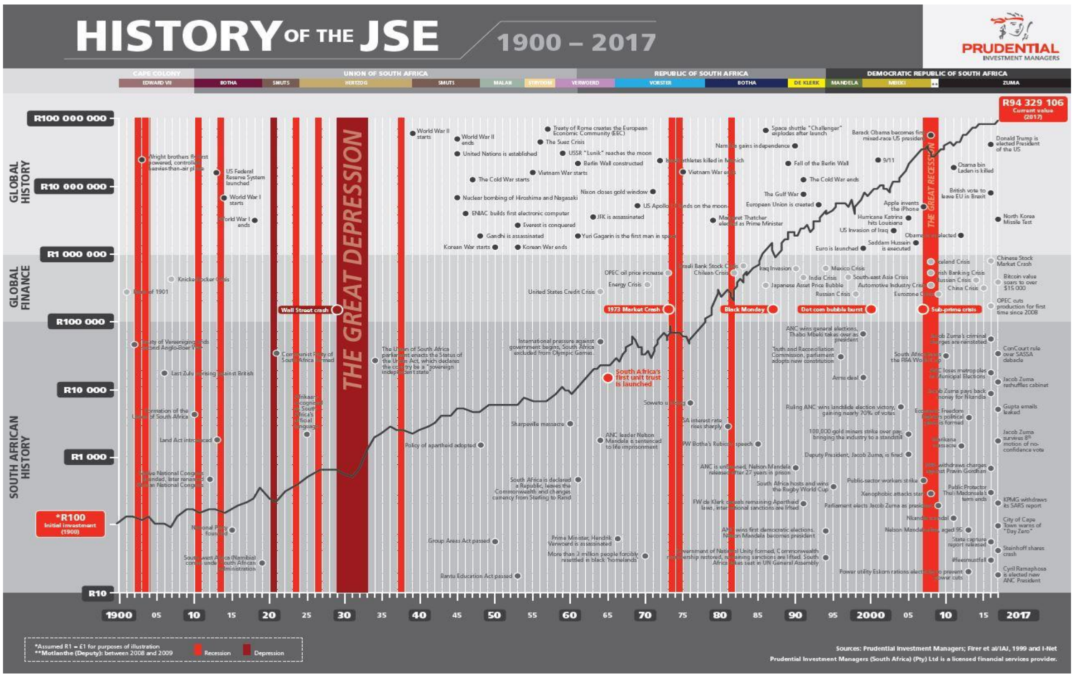
Hewett Wealth

LONG TERM INVESTMENT CASE FOR GROWTH ASSETS

I trust that you had a wonderful break and enjoyed some quality family time over the festive season.

Upon reflection of where worldwide markets closed after a torrid 2018 calendar year, I thought it may be an opportune time to highlight some key factors that are important to keep in mind when looking at your asset allocation moving into 2019.

As per our December edition of Finance matters, you will recall the graph below that shows us that over the longer term, it makes sense to ignore market “noise”. Even events like the great depression, the currency crisis and a number of other significant market disruptions over the last 117 years ultimately fade into distant memory and the market continues to do what it does best – to value assets based on long term fundamentals and not on noise – and 2018 will be no different.



Source: Prudential Investment Managers

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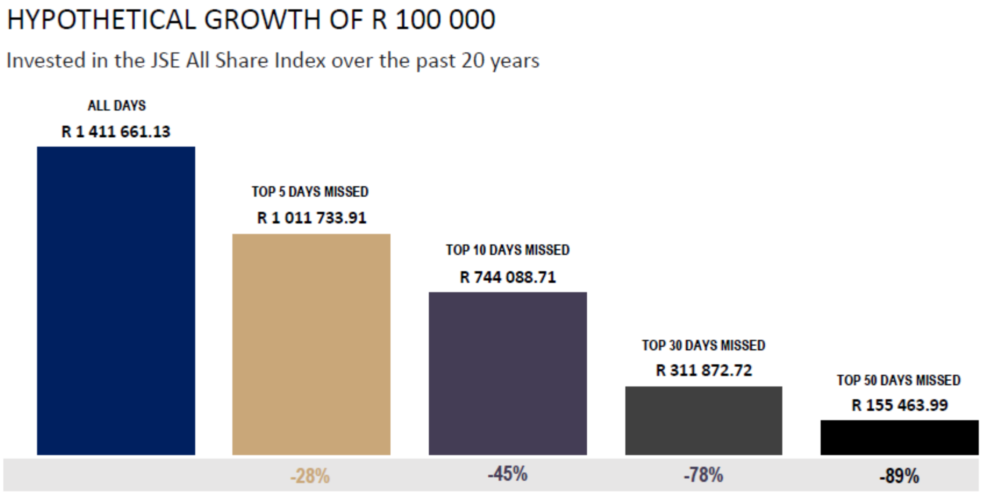
Looking at the above and taking account of the fact that this trend holds true for equity markets in general, it is clear that equity investment delivers exceptional inflation beating returns over the longer term. The question then however on many people's mind is – "would it not make sense to withdraw funds when markets are underperforming as they are at the moment and to reinvest when they show signs of recovery?"…This is however easier said than done and as can be seen from the bar chart below, trying to time the market could be a very costly strategy. In this example, that takes account of actual daily market returns over the last 20 years, if you remained in the market throughout and stuck to your asset allocation strategy, you would have achieved a gross return in excess of 13% per annum over the 20 year period, whereas had you withdrawn funds based on market fluctuations and news flow or "noise" and due to this had missed only 5 of the best days during the term, you would have reduced your annualised return by around 1,5% per annum. As an extreme example, if you had missed just 50 of the best days on the market over this 20-year period, you would have reduced your return to only 2,2% per annum. Markets are extremely volatile at the moment and the likelihood of timing your trading activity so well that you are able to capture the upswings whilst avoiding the downswings and at the same time covering the excessive costs associated with this strategy is extremely unlikely!



Source: Glacier

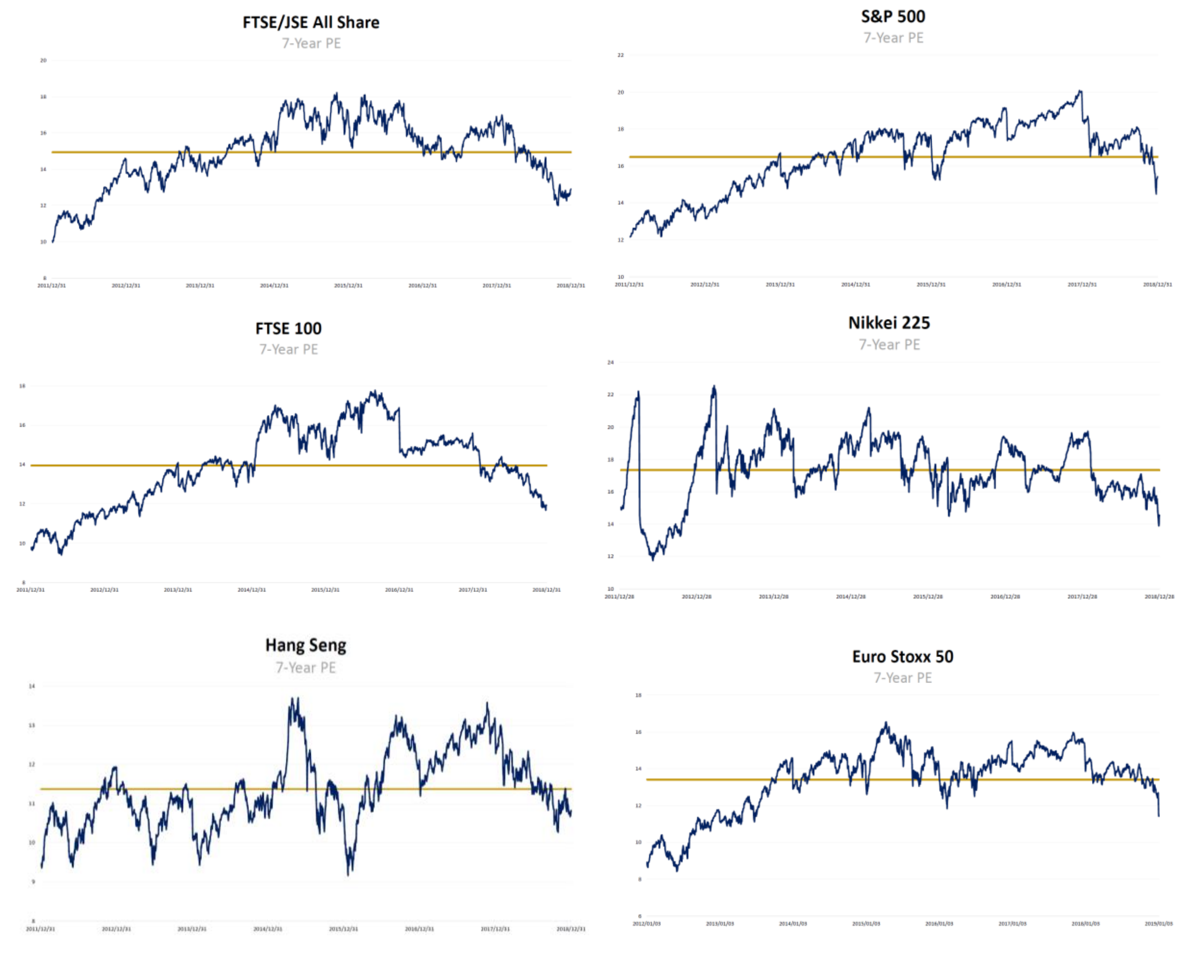
Emerging market returns are moderating and gradually converging with developed market returns and developed market returns have moderated in line with worldwide inflation. The key is to ignore short term nominal returns and to design your longer term investment strategy to achieve inflation beating returns over time – this creates real wealth.

Looking at our local markets, we do face some serious headwinds including a dire position on the state finance front preventing meaningful investment in economic growth, failing SOE's, rife corruption, high crime rates and I suppose the list goes on. On the positive front however, regardless of the perception that not enough is being done, significant changes have been made to almost all SOE boards; fraud and corruption charges are being levelled against very senior, previously "untouchable" political figures and many have been removed from their posts; changes have been introduced to police recruitment processes – and this list also goes on…

Similarly, internationally we have Brexit, an unstable Eurozone, trade wars, a US government shutdown, renewed violence in Northern Ireland, French Yellow-Vest riots and as above, the list goes on … but we still have a projected world growth rate of around 3,5% in 2019 and trying to predict whether this will improve or deteriorate as all of these issues play out is an impossible feat. The expression "this too shall pass" comes to mind…

So again, we are back to the question "would it not make sense to withdraw funds when markets are underperforming as they are at the moment and to reinvest when they show signs of recovery?" Based on the fact that this is clearly not an investment strategy but more of a gamble, we need to turn to longer term fundamentals.

Although there are many ways to assess market valuations and longer term trends, one of the most common measures is very simply what you need to pay, as a multiple of sustained earnings generated by a company, to purchase that company's shares. Looking at this measure as an average of all listed companies across multiple markets over a 7 year period, you will note that markets became relatively expensive during 2017 and into 2018. The "pull-back" however over the course of 2018 and more specifically in late 2018 was very significant and as can be seen below, many markets now offer longer term price-earnings valuations well below the 7 year average, thus offering some exceptional stock picking opportunities, but not without significant short to medium term volatility…



Source: StrategiQ Capital

Ultimately, as can be seen below, all asset classes react differently to varying structural and economic conditions but in the longer term, the relative asset class returns remain intact – higher risk, higher return – hence the need for diversification and a longer-term investment view.

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1 Year Returns															5 Year Return	10 Year Return	15 Year Return
Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18			
SA Equity 41.2%	SA Real Estate 42.5%	SA Equity 36.7%	SA Real Estate 21.4%	SA Bonds 16.1%	SA Equity 27.2%	SA Real Estate 24.1%	Foreign Equity 11.5%	SA Real Estate 31.5%	Foreign Equity 52.2%	SA Real Estate 25.1%	Foreign Equity 29.1%	SA Bonds 12.8%	SA Real Estate 14.1%	SA Cash 7.4%	Foreign Equity 8.2%	Foreign Equity 11.8%	SA Real Estate 14.7%
SA Real Estate 34.2%	SA Equity 36.9%	Foreign Equity 31.0%	SA Equity 17.6%	SA CPI 12.1%	SA Real Estate 12.5%	SA Equity 18.5%	SA Bonds 8.5%	SA Equity 20.0%	SA Equity 19.4%	Diversified 12.4%	SA Real Estate 10.8%	SA Cash 7.5%	SA Equity 12.8%	SA Bonds 6.2%	SA Cash 7.0%	SA Real Estate 10.9%	SA Equity 13.1%
Diversified 19.0%	Diversified 24.0%	SA Real Estate 25.8%	Diversified 11.7%	SA Cash 11.9%	Diversified 10.8%	SA Bonds 14.7%	SA Real Estate 7.6%	Foreign Equity 18.6%	Diversified 17.4%	Foreign Equity 11.9%	Diversified 9.1%	SA CPI 6.6%	Diversified 10.6%	SA CPI 5.2%	SA Bonds 6.8%	SA Equity 10.1%	Diversified 9.8%
SA Bonds 14.1%	Foreign Equity 23.3%	Diversified 21.3%	SA Cash 9.5%	Diversified -4.5%	SA Cash 9.1%	Diversified 12.3%	Diversified 7.3%	Diversified 18.2%	SA Real Estate 9.2%	SA Equity 10.3%	SA Cash 6.4%	SA Real Estate 5.8%	Foreign Equity 9.7%	Foreign Equity 1.1%	Diversified 6.5%	Diversified 9.8%	Foreign Equity 9.6%
SA Cash 7.7%	SA Bonds 10.4%	SA Cash 7.3%	SA CPI 7.9%	SA Real Estate -4.5%	SA CPI 5.2%	SA Cash 6.9%	SA CPI 6.2%	SA Bonds 15.4%	SA CPI 5.4%	SA Bonds 9.0%	SA CPI 4.7%	Diversified 4.4%	SA Bonds 8.9%	Diversified -3.3%	SA Real Estate 5.5%	SA Bonds 7.3%	SA Bonds 8.1%
SA CPI 4.6%	SA Cash 6.9%	SA Bonds 5.5%	Foreign Equity 6.2%	SA Equity -22.9%	Foreign Equity 5.2%	SA CPI 3.5%	SA Cash 5.5%	SA CPI 5.5%	SA Cash 5.1%	SA CPI 5.8%	SA Equity 1.0%	SA Equity 3.1%	SA Cash 7.7%	SA Equity -9.1%	SA CPI 5.4%	SA Cash 6.7%	SA Cash 7.3%
Foreign Equity -2.2%	SA CPI 3.7%	SA CPI 5.0%	SA Bonds 4.0%	Foreign Equity -23.0%	SA Bonds -0.1%	Foreign Equity -2.5%	SA Equity 3.3%	SA Cash 5.4%	SA Bonds 1.1%	SA Cash 5.8%	SA Bonds -2.0%	Foreign Equity -7.4%	SA CPI 4.6%	SA Real Estate -21.9%	SA Equity 3.3%	SA CPI 5.3%	SA CPI 5.7%

Diversified returns are calculated using the sectors weighted evenly at 20%.

Sources: MacroSolutions, Morningstar, Category returns

A sure-fire way to realise losses is to try to time the market and to change your investment strategy based on news flow instead of fundamentals. The crux of the matter is that it is critical to ensure that your asset allocation takes account of your tolerance for risk as well as your short, medium and long term needs and objectives and that you stick to your investment strategy – even if it takes years, which these cycles often do!

I wish you all the very best for 2019 and look forward to being of service!

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