

## Whichever way you look at it, 2018 was a tough year for South African investors

Today is my first day back in the office after a long festive break. This was the first time in my 23 year career that I have taken a full month's leave. The main reason for this is that 2018 wore me down like no other business year has. I suspect that another reason is that I am well into my forties so it is getting harder to keep going at the rate I used to. Somehow though 2018 just seemed to wear me down in a way that no other year has, even despite the fact that we started Gradidge-Mahura Investments (GMI) in the middle of the global financial crisis of 2008.

### What made 2018 such a tough year for me as an adviser and for you, our clients?

2018 was yet another tough year after 3 tough years. The stock market has been in a volatile sideways move since September 2014. The JSE delivered its worst 5 year return since the 1950's. So investors' patience has been tested over an extended period. We saw a number of clients capitulate, abandon their long term investment plans and move their portfolios to the safety of cash.

The past 5 years have also been characterised by an incredibly volatile economic environment, largely dominated by politics. Revelations of massive fraud and thievery in public and state owned entities, and the resultant collapse in service has resulted in higher personal taxes, and rattled investor confidence. This in turn has led to lower investment, increased job losses, higher administered prices, and ultimately higher unemployment. The country has essentially been in a holding pattern since the ANC elective conference as the president was unable to secure a strong enough mandate to effect the required reforms. This has made it difficult for many investors to stick to their long term investment plans.

The other significant challenge from 2018 was the fact that investors experienced weakness across the board. Peter Armitage of Anchor Capital summed it up well in a note to their clients this month.

*"December capped an incredibly challenging year for global investors. The S&P 500 Index had its second-worst month (-9.2% MoM) since the Great Depression resulting in its worst year (-6.2% YoY) since 2008. Meanwhile, the MSCI World Equity Index ended the year down 10.4%. It was also the first time in many years that all major global asset classes produced a negative real return. Emerging markets (EMs) seemed to bear the brunt of the risk-off environment throughout the year which meant that it was another very disappointing 12 months for investors on the JSE. The FTSE JSE All Share Index closed 2018 with a negative total return of 11.5%, which is particularly painful given that over a four-year period it has produced a paltry annualized total return of 4.6%."*

The average balanced fund in South Africa delivered a return of -3.6% with only 17 funds out of 164 managing a positive return. Once investors deduct administration and advice fees, these returns fall to -5% for the year. Growth investors would have experienced lower returns as they would have had more exposure to equities, property and offshore.

Retired investors would have benefited from their higher exposure to local bonds and cash which delivered positive returns in the region of 7% net of fees. However, these investors would have had some exposure to equities, property and offshore in order to get better long term returns. The average return in the low equity category was 1.36% before fees, meaning that the average retired investor barely got a positive return from their portfolio. Once income drawdowns are accounted for, the majority of retired clients would have experienced a loss in their portfolios in 2018. In most previous market downturns, retired clients were often largely shielded from losses, not so in 2018.

### What detracted from performance for GMI clients in 2018?

The main area where our clients would have taken a hit in 2018 would be in their exposure to listed property. Our investment philosophy is premised on the principle of diversification. As a result we included an exposure to listed property – especially for income seeking clients, and long term tax free savings investments.

### What worked for GMI client portfolios in 2018?

The continued focus on reducing fees added value to our clients' portfolios. When returns are low it is important that they are not dragged lower by fees. We achieved lower fees by including index funds, cheaper classes of existing funds and/or managers who charge below industry averages, in client portfolios. Our clients' portfolios cost less than half the industry average as a result of these efforts over the past 10 years.

We continue to adopt a cautious approach to building client portfolios. In 2014 I was interviewed by Finweek and asked for our expectations of markets in the future. We recommended then that clients start reducing their exposure to equities and adopt a more cautious approach to their portfolios.

In 2017 we were asked to review this advice, and we continued to advocate for a more cautious approach. This approach has resulted in client portfolios largely outperforming the relevant sector averages over the period.

The managers that we use for portfolios have largely done relatively well. Managers like Allan Gray, ClucasGray, and Satrix have outperformed. Some of our managers like Foord, Prudential and Bridge haven't fared as well, but their underperformance has been relatively marginal. Once combined with lower fees and a more cautious approach, client portfolios have weathered the storm relatively well.

### Where to from here?

We remain committed to our investment philosophy which has delivered consistently good returns for our clients since we started the company in 2008. We will continue to apply the principles of diversification, look for ways to reduce client fees further, and seek to minimise downside risk. Given that investing is a forward looking activity with inherent uncertainty and complexity, investors are best served by a long term mind set and by sticking to proven principles.

There are a number of big issues affecting markets at the moment. Locally the national elections dominate the mind of investors, as do the low rate of economic growth and the perilous state of SOEs such as Eskom, SAA and others. A messy (violent, contested) election could see an increase in the number of investors taking their funds offshore. The drop in investment could see a continued rise in unemployment and economic activity. The debt issues at Eskom in particular remain a significant threat to the fiscal position of the country. This could see further tax hikes and lower economic activity. The talk of introducing prescribed assets introduces further risk for local investors.

On the positive side it is unlikely that interest rates will rise further in this environment, especially with low demand and falling oil prices keeping a lid on inflation. Globally we could see trade tensions between the US and China ease as the impact of the current stand-off is felt in markets. The issue of Brexit is coming to a head, and any resolution will see that uncertainty disappear. There is also increased optimism for emerging markets as valuations start to become relatively attractive.

We continue to urge investors to remain committed to their long term investment plan. Markets often correct BEFORE the economic position improves. History has repeatedly shown that the recovery often happens during tough economic conditions, and not after they are resolved. Our local market is also cheap, meaning that dividend and rental yields are higher. This is supportive of improved returns in future. One thing that is not obvious to many investors is that they have a lot more units in their portfolios now than in the past. The values of those units are lower as a result of market weakness. When the market recovery comes portfolios will likely increase sharply as a result of the increase in value of units, and because there are more units. Disinvesting before then robs clients of this.

As always do not hesitate to contact your adviser if you wish to discuss any aspect of your investments.