



THE BEST OF TIMES, THE WORST OF TIMES...

For the past couple of years, we have witnessed the best of times in the South African market: an unprecedented bull market offering potential to create wealth for investors. But how many investors were invested in the market for long enough to make the most of the opportunity?

Conversely, the current volatile market and uncertainty on many fronts is making many of us fear that it is now the worst of times. The reality is that the corrections may create new long-term opportunities to grow your wealth. For many investors this could, in hindsight, turn out to be the best of times.

When faced with volatile markets short-term investment strategies can be dangerous.

→ Emotive responses erode wealth.

→ Research proves that market timing doesn't work.

→ Focus on how long you invest to improve your returns.

After a period of high and rising share prices, the market will drop, only to rise again

In recent times and off the back of a global bull market, investor expectations have been skewed. We have come to expect investor returns to be positive and feel fearful if 'normal' corrections occur. The market has historically shown its tendency to return to its long-term average. The consequences of this are that, after a period of high and rising prices, these inevitably do drop, only to rise again. Although market returns have been remarkably steady over long-term periods, they are subject to considerable variation from year to year (and even from day to day). The important thing to remember is that long-term averages are made up of peaks and troughs, and each is a consequence of the preceding period.

The link between high volatility and poor investor returns

The link between high volatility and poor investor returns (and lower volatility and better investment returns) makes intuitive sense. After all, when the market is volatile, much is made of upward short-term gains, which entice investors. But, inevitably, and as history has shown, the sharp movements up are often followed by sharp movements down, spooking investors who then bail out. Ironically, this could probably be just the time to be investing more! Because we are human and not always rational, we often respond to our emotional impulses. In so doing, we erode any potential to take advantage of volatility by mistiming investments and withdrawals.

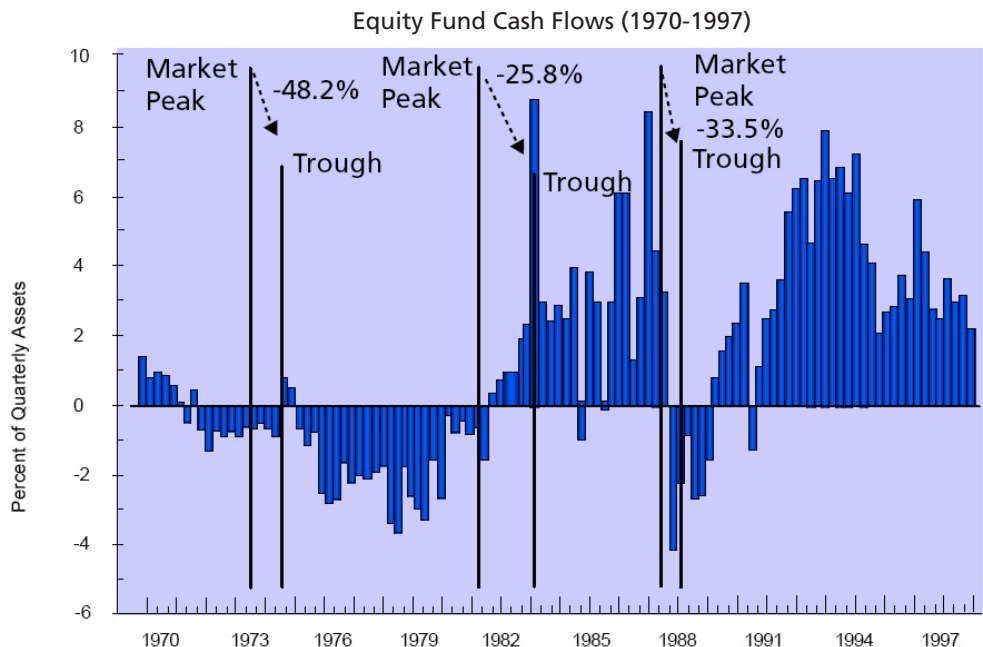
Short-term strategies are inherently dangerous

Numerous examples demonstrate that short-term investment strategies are inherently dangerous and result in a high turnover of investments in portfolios that are designed to achieve long-term goals.

So is it possible to get the timing right? Research indicates that it isn't.

1. US equity mutual fund experience shows that following the 48% market decline in 1973-1974, investors made withdrawals from their holdings of equity mutual funds during 24 consecutive quarters, from the second quarter of 1975 to the first quarter of 1981. The cumulative total withdrawn was US\$14 billion, 44% of the value of the initial holdings.

Investors made particularly heavy investments in the first nine months of 1987 (US\$28 billion of the US\$80 billion inflow). Most of these investors bought at inflated prices. Then the market crashed in 1987 and investors crystallised their 'losses' and disinvested.



Source: 'Common Sense on Mutual Funds' by John C. Bogle

2. A different study conducted by FactSet Research Systems Inc, illustrated in the table below, shows that it is very easy to miss the best-performing days. If you do, you will have substantially worse performance than if you had stayed invested the entire time. Unless you have a crystal ball you may miss major upward market moves and undermine your returns.

Missing the Market ¹		
S&P 500 Index: 31 December 1994 – 31 December 2004		
Period of Investment	Average Annual Total Return	Growth of \$10,000
Fully invested	12.07%	\$31,260
Missed the 10 best days	6.89	19,476
Missed the 20 best days	2.89	13,414
Missed the 30 best days	-0.39	9,621
Missed the 40 best days	-3.19	7,233
Missed the 60 best days	-7.90	4,390

1. FactSet Research Systems Inc.

3. In 1975 William Sharpe published an article 'Likely Gains from Market Timing'. In this he demonstrated statistically that to benefit from market timing you had to guess right 74% of the time. Historic performance data confirms this.

4. In a well-known analysis of the performance of 91 pension plans from 1974 to 1983 by Brinson, Hood, and Beebower, they determined that market timing had not added to, but detracted from, performance.

Focus on what is within your control: the length of time that you hold your investments

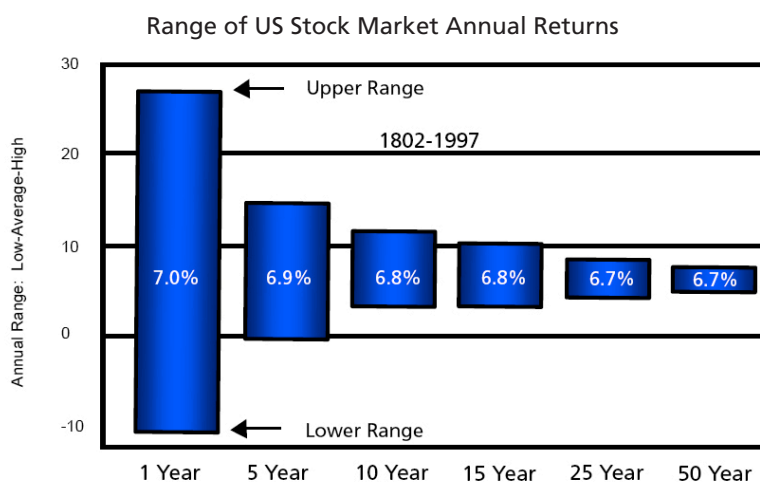
How do you avoid a feeling of helplessness when you see the extreme volatility and uncertainty around you? As investors, we are not able to directly influence the short-term returns of shares (or bonds or other asset classes for that matter). You can however influence the long-term returns you get from your investment by focusing on what is within your control: the risk that your investment is exposed to, and the time period over which you invest. If you focus on the length of time that you hold an investment, you are able to:

- Decrease variability of returns (or the risk you are exposed to)
 - Increase your returns through the power of compounding
- The longer your time horizon, the more certain your average annual returns.

Variability of returns decreases with time

Risk is often defined as the variability of returns, or upward and downward movement in returns. There are several ways to measure this variation or volatility of returns. The most frequently used and academically accepted measure is standard deviation. This is a statistical measure of the range of investment returns over a certain time period. More accurately, it is actually a measure of price volatility.

Annual share price returns can fall beyond the ranges described by their standard deviations. For example, the US market all-time high, reached in 1862, was a real return of 66.6%. The all-time low was recorded in 1939, with a real return of negative 38.6%. The wide variations tend to decline over time. The chart below shows that a one-year standard deviation of 18.1% drops by more than half to 7.5%, over just five years. It nearly halves again to 4.4% over 10 years. It continues to decrease the longer the timeline.



	Standard Deviation of Returns (%)					
Upper Range	25.1	14.4	11.2	10.3	8.7	7.7
Lower Range	-11.1	-0.6	2.4	3.4	4.7	5.7
Standard Deviation	18.1	7.5	4.4	3.3	2.0	1.0

Source: 'Common Sense on Mutual Funds' by John C. Bogle

The power of compounding to increase your returns over time

Monthly savings (invested at the beginning of each month)	Total invested over 5 years	Value at the end of the 5 year period to 23 September 2008	
		FTSE/JSE All Share Index**	* After tax cash in bank (25% tax rate)
R 20	R 1,200	R 2,266	R 1,397
R 50	R 3,000	R 5,665	R 3,493
R 100	R 6,000	R 11,329	R 6,986
R 500	R 30,000	R 56,646	R 34,932
Annual compound growth rate (compounded monthly)	n/a	23.1%	5.9%

Monthly savings (invested at the beginning of each month)	Total invested over 10 years	Value at the end of the 10 year period to 23 September 2008	
		FTSE/JSE All Share Index**	* After tax cash in bank (25% tax rate)
R 20	R 2,400	R 7,575	R 3,418
R 50	R 6,000	R 18,937	R 8,545
R 100	R 12,000	R 37,874	R 17,089
R 500	R 60,000	R 189,372	R 85,446
Annual compound growth rate (compounded monthly)	n/a	19.9%	6.7%

* SteFI Call - Short-term Fixed Interest Call Deposit Index. (STFCAD)

**Total return index. (J2037)

Note: Given that performance over the last 10 years has been exceptionally positive, going forward, 5-10 years may not necessarily be long enough to beat the returns on cash.

Great in theory, poor in practice

Unfortunately the importance of time in shaping returns is noted more by examples of when investors do not use time appropriately and are not patient enough, rather than positive examples of how time has created wealth. It is almost a theoretically accepted argument, but the practice of using this to create wealth is rare. Unit trust investing as an example is sensitive to market movements as investors are able to switch funds and take their money away with ease. The accessibility and liquidity (ironically one of the benefits) of unit trusts tends to have adverse consequences for many investors as they try to time the market.

What you can do to improve returns

Beware the hype: information and news overload

Beware of basing your investment decisions on sensationalist marketing. The reality is that investors suffer from information overload. Attention-seeking headlines and adverts often mirror, and in some instances magnify and sensationalise, the actions of investors and therefore the market.

A well known US business publication ran a cover story 'The Death of Equities' on August 13, 1979 when the Dow Jones Industrial Average of share prices was 840. The Dow Jones average rose to 960 by the end of 1980, dropped to 800 in July 1982 but rebounded to 1200 by May 1983. In May 1983 it published another cover story (after a 50% rise in the average) titled 'The Rebirth of Equities'. Effectively saying 'Sell' at 840 and 'Buy' after it had climbed to 1200.

The purpose of mentioning this is not to malign the media, as they do play a valuable role in investor education in many ways. The intention is to highlight that the market is simply unpredictable on a month-to-month and even year-to-year basis. We should not expect it to be predictable, nor should we base our investment decisions on the impulses inspired by 'conventional wisdom' of the day. Whether inspired by large headlines in credible and respected publications, or arising from irresponsible marketing hype, our own hope, fear or greed – these emotive calls to action should be ignored.

Be clear on your objectives from the outset

The purpose of making an investment is to grow your wealth. It is important to be clear on your goals and objectives before investing so that short-term ups and downs don't steer you off course.

Educate yourself about investing or engage the services of an expert to assist you

It is very important to make time to educate yourself about investing; alternatively, you can engage the services of a professional independent financial adviser. An independent adviser can be vital in helping you to meet your objectives and grow your wealth. They are able to help you consider your investment decisions holistically in the context of the rest of your investment portfolio and other individual financial circumstances. They also provide expertise about the different investment options and assess which product is most appropriate for your needs.

Unit trusts offer access to experts, spread the risk of investing in one share to many shares and instruments, and provide safeguards. You also have access to your investment at any time – which can be a double-edged sword. By taking your money out too soon, you undermine your ability to make money from your investment.

Commitment, patience and discipline reaps its rewards

The recent volatility is a healthy reminder about the short-term uncertainty of financial market returns. But it is also evidence of the opportunity this presents to create real wealth over time. This comes with a caveat: you need to be disciplined, patient and focus on the long term.

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