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Previously Investec
Asset Management

Cash costs money over the longer term

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The fast view

— Investors are believed to feel the pain of loss more than the pleasure of gain (loss aversion).

— This theory is proven time and time again during market corrections when many investors switch from their growth investments to cash.

— However, an analysis of the past nine bear markets shows that the best action is to do nothing and remain invested.

— During uncertain times, together with your financial advisor, it is best to revisit your long-term financial goals and recommit to the plan you have put in place to achieve them.

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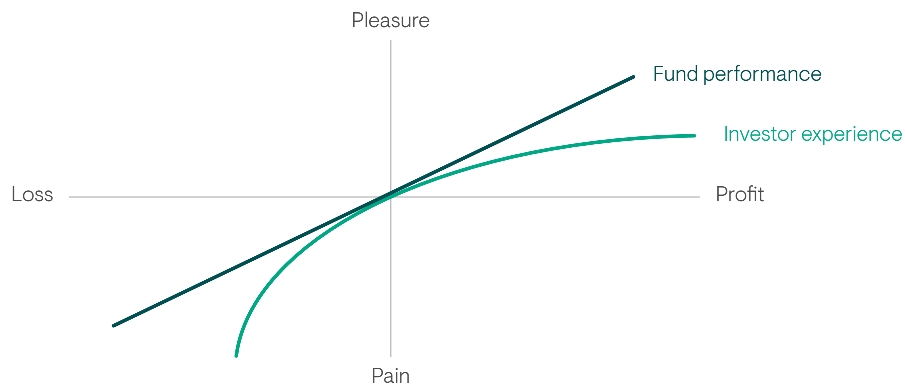
Loss aversion is a powerful concept in behavioural finance, first articulated by Kahneman & Tversky in 1979. Simply put, investors are believed to feel the pain of loss twice as strongly than the pleasure of gain, as illustrated in Figure 1.

Figure 1: How investors experience fund performance



Source: Based on Kahneman & Tversky's Prospect Theory: An Analysis of Decision under Risk.

In Figure 1, the dark green line illustrates fund performance – on the right-hand side of the vertical axis performance is positive (investors make a profit) and on the left, performance is negative (investors make a loss). The light green line represents investors' experience of that profit or loss, illustrating that the pleasure investors receive from incremental profits is less than the pain associated with incremental losses.

Unfortunately, this theory is proven true time and time again during market corrections such as we experienced in Q1 of 2020. Unable to stomach these significant losses, many investors panic and switch from their growth investments to cash, thereby crystallising what was only a paper loss until that point.

An analysis of the Association of Savings and Investment (ASISA) industry flows reinforces this. ASISA has data for the periods around the last two bear markets (2002 and 2008) prior to the current one. Simply, in the final stages of the bull market, investors were pouring money into equity funds (higher risk/higher reward investments), and then in the year following the stock market collapse, they were withdrawing money from equity funds and investing the proceeds into money market and income (lower risk/lower reward) funds.

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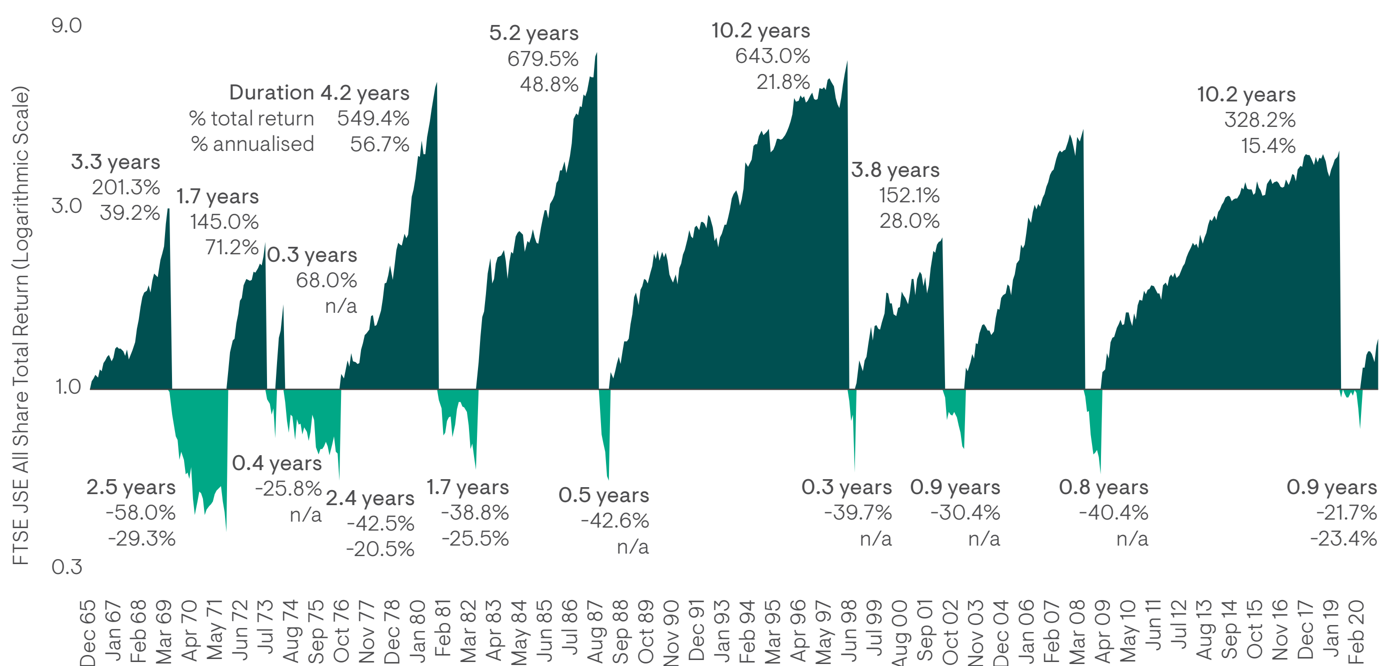
50 plus years of SA equity market performance - what does it tell us?

In the following section, we consider the client experience following all SA equity market corrections of more than 20% over the past 50 years, including the latest correction from February 2020. As illustrated in Figure 2, you will note that since 1965, there have been no fewer than nine corrections where the market has fallen by more than 20%.

Figure 2: History of SA bear and bull markets since 1965 (FTSE/JSE All Share Total Return (logarithmic scale)



Bull markets	From the lowest close reached after the market has fallen 20% or more, to the next market high
Bear markets	From when the index closes at least 20% down from its previous high close, through the lowest close reached after it has fallen 20% or more

Source: Bloomberg, Deutsche Bank and Ninety One as at 31.12.20.

Some observations:

- Bear markets are often deep, but importantly short.
- Bull markets take longer to play out, giving rise to the over-used phrase; 'bull markets climb a wall of worry', but importantly, bull markets more than reward those investors that stay invested.
- The recovery from the bear market is often very swift; anyone sitting on the sidelines is unlikely to benefit.

With the benefit of hindsight, was the decision to switch to cash the right one? We believe not and point to the following analysis in which we have considered the outcome of two investors who both invested R10 000 prior to each of the last nine bear markets (i.e. at the market peak). Let's call them Mo' Money and Lo' Money.

While admittedly concerned about the impact of the market collapse on his nest egg, Mo' Money weathered the storm, remaining invested throughout. Lo' Money unfortunately could not stomach the impact of the market collapse on his nest egg and switched to cash at the market trough. Then, true to the psychology of many investors, noticing that the stock market was recovering and not wanting to miss out, he reinvested into the market a year later. Lo' Money subsequently repeated this behaviour in each subsequent bear market. The following table illustrates just how punitive Lo' Money's decision to switch to cash was on his potential retirement capital.

Figure 3: Comparing staying invested versus switching to cash

	Mo' Money experience (stay invested)		Lo' Money experience (Move to cash for 12 months post market low)	
Bear market	**Value of R10 000**	**Annualised return**	**Value of R10 000**	**Annualised return**
Jan-70	20,971,449	16.2%	1,081,820	9.6%
Jun-73	13,277,056	16.3%	1,237,589	10.7%
Mar-74	10,644,064	16.1%	1,625,032	11.5%
Oct-80	2,851,876	15.1%	391,772	9.6%
Aug-87	597,707	13.1%	159,291	8.7%
May-98	150,970	12.8%	55,307	7.9%
May-02	92,168	12.7%	39,717	7.7%
Apr-08	28,180	8.5%	15,689	3.6%
Apr-19	10,654	3.9%	8,111	-11.8%

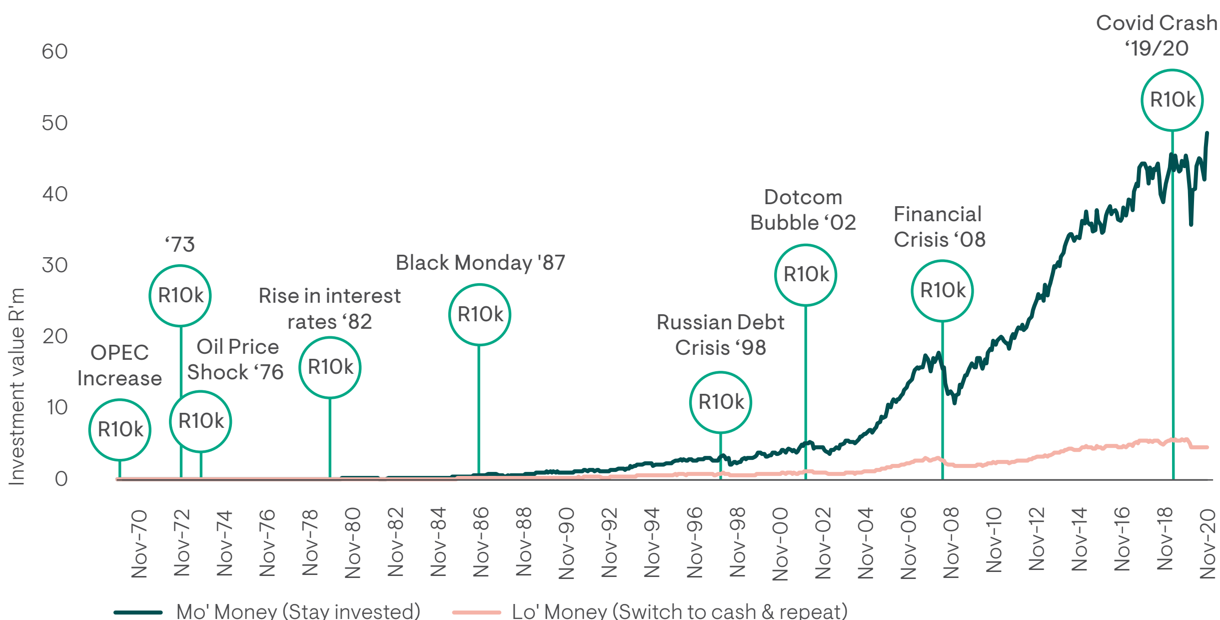
Source: Ninety One Benchmark database.

Some observations:

- In every instance, the switch to cash was detrimental to Lo' Money's total investment return.
- The power of compound interest is evident over the long term; R10 000 growing to R20.97 million over approximately 50 years. Interestingly, this was only R15.4 million immediately post the market collapse of March 2020. Simply staying invested meant that you were 25% better off by the end of 2020!
  - A 6.6% p.a. higher annualised return over a 50-year period results in 20 times more money at the end of the period .
- Many may argue that 50 years is far too long an investment time horizon but consider someone starting work in their early twenties; he would (should) save for retirement for 40 years and then expect to live off his retirement savings for a further 25 years or so – a total investment period of 65 plus years!

As a final point, we considered the case where Mo' Money invested R10 000 at the peak prior to each of the last nine bear markets (i.e. a total investment of R90 000) and compared that to Lo' Money making the same investments at the peak, but then at the trough of each bear market, switching his accumulated investment to cash for a year before switching back to the market. The results are astounding. Over 50 years Mo' Money's investment grew to approximately R48.6 million (an annualised return of 16.1%), compared to Lo' Money's R4.6 million (an annualised return of 10.4%).

Figure 4: Time in the market versus timing the market



Source: Ninety One benchmark database.

Considering the erosive effect of inflation

The graph overleaf further illustrates just what a poor investment cash is in preserving the purchasing power of your money over the longer term. You will note that over the last ten years many components of inflation (electricity, health costs and education) have increased by more than the return achieved by the average money market fund. So, anyone invested in the average money market fund would have been spending a greater portion of their income on these necessities, which they would have had to subsidise from other sources (if possible) as their money market fund investment has not kept pace with these increases.

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Figure 5: Hiding in cash doesn't protect you from inflation over the long term

200%
180%
160%
140%
120%
100%
80%
60%
40%
20%
0%

Dec-09 Mar-10 Jun-10 Sep-10 Dec-10 Mar-11 Jun-11 Sep-11 Dec-11 Mar-12 Jun-12 Sep-12 Dec-12 Mar-13 Jun-13 Sep-13 Dec-13 Mar-14 Jun-14 Sep-14 Dec-14 Mar-15 Jun-15 Sep-15 Dec-15 Mar-16 Jun-16 Sep-16 Dec-16 Mar-17 Jun-17 Sep-17 Dec-17 Mar-18 Jun-18 Sep-18 Dec-18 Mar-19 Jun-19 Sep-19 Dec-19 Mar-20 Jun-20 Sep-20 Dec-20

Power
Health costs
Education
Average Money Market Fund
Food
Petrol
CPI
Housing

Source: Bloomberg, Morningstar to 31.12.20.

Stay the course with an inflation-targeted multi-asset fund

There are several behavioural biases that lead to investment mistakes. The analysis provided illustrates just how detrimental succumbing to loss aversion is to investors' potential returns. During these uncertain times, together with your financial advisor, you need to revisit your long-term financial goals and stay true to the plan that you have put in place to achieve them. You need to act rationally and calmly as you expect your financial advisor and investment manager to do on your behalf.

In our view, the optimal investment solution for many investors may be an inflation-targeted multi-asset fund that also seeks to shield investors from negative market corrections, such as the:

- Ninety One Cautious Managed Fund, which targets inflation plus 4% over meaningful periods (three - five years) and no negative returns over rolling 18 months
- Ninety One Opportunity Fund, which targets inflation plus 6% over meaningful rolling five years and no negative returns over rolling 24 months

In both instances, diversification, active asset allocation and disciplined portfolio construction are important tools in managing downside risk.

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