

## Why investors can miss BlackFriday sales

The recent BlackFriday deals present an interesting perspective from which to view investor behaviour, and can help reinforce the traits we as investors need to demonstrate to ensure we remain on track with our longer term goals.

The rationale behind the BlackFriday purchasing makes sense - enormous price cuts means shoppers are buying at a discount and getting the most value for their money. Buy cheap, right?

Wrong. At least, this is not the behaviour we often witness in investing. Why do investors tend to avoid 'buying cheap' when it comes to buying shares? This odd outcome can be explained by behavioural biases which most people exhibit. In investing, the purchase (or sale) decision is often clouded by emotions, which can lead to costly outcomes.

It's a reasonable process of elimination to get the best value we can find. In fact, many people will wait until days like Black Friday or big sales to purchase something they need/want at a cheaper price. Statistics show that 30-40% of retailer's annual sales occur between Black Friday and Christmas. Alibaba Group just boasted sales of \$10 billion in one hour of a flash sale they hosted. The exclusivity of a sale in terms of time constraints and limited stock creates a buying frenzy.

This frenzy is also evident in investing. Herding mentality occurs when investors don't want to be left out of a trend or a movement. This "fear of missing out" behaviour causes investors to follow their peers ('the market') even though this may not be in their own best interests. They tend to lose sight of the real value of what they are buying. With sales, if shoppers give in to these biases, they are still buying at a low price. However, with investing, the opposite tends to apply, where we see buy high/sell low behaviour, with losses locked in, and profits foregone.

Chart 1 shows the emotional reaction of investors as the price of an investment rises and falls.

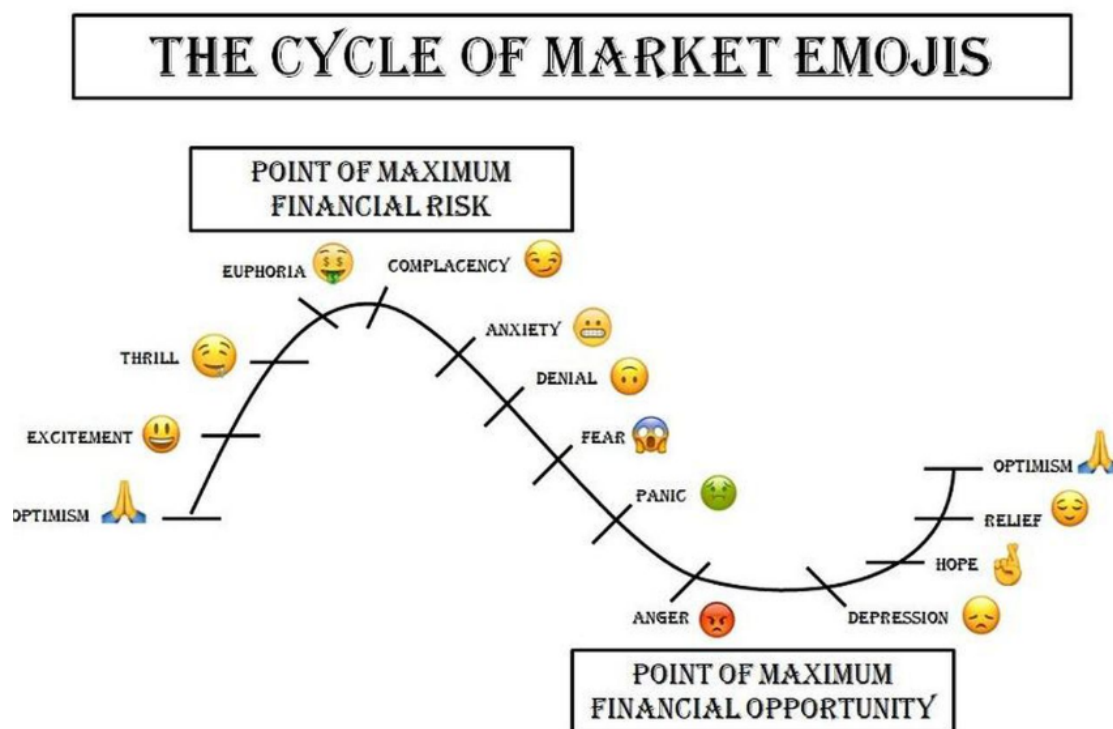


Chart 1: The Cycle of Market Emojis (source: Forbes)

So, what does this mean for investment returns? When buying at a lower price, the potential for great returns is higher due to the low cost base. Chart 2 shows the relationship between the price-earnings (P/E) ratio of a stock and the corresponding next three-year returns. The price-earnings ratio of a share is a measure of its “cheapness”. If a share has a low P/E ratio, this would indicate a cheap price (a BlackFriday price), and if the PE is high this would indicate an expensive price (BlueMonday?) Based on the chart one can see that the higher the purchase price, the lower the future return prospects. The left-hand side of the chart shows the returns earned when buying at low prices – such as Black Friday purchases. The right-hand side of the chart show the returns you would expect when buying at high prices– the “Blue Monday” prices:

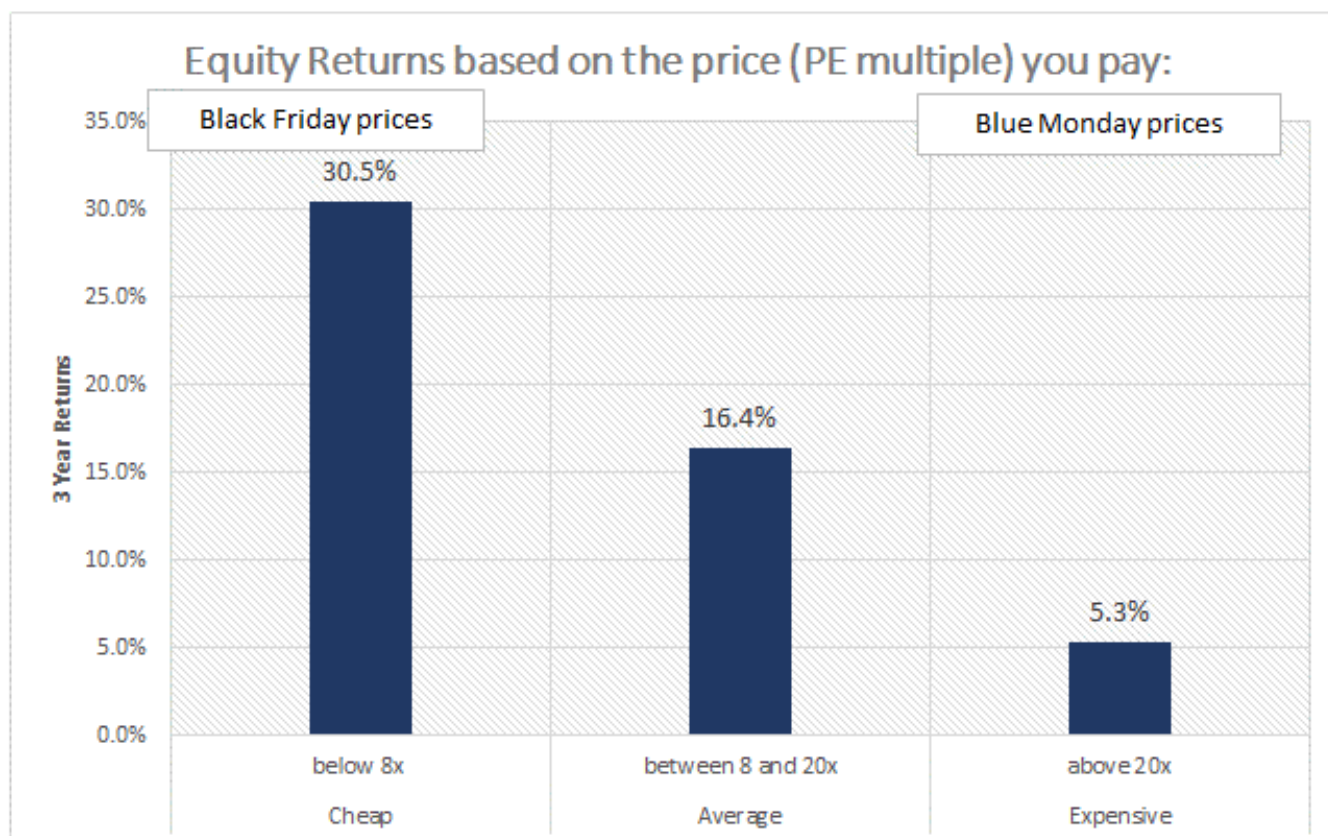


Chart 2: Price Earnings vs Future 3 year returns on the JSE

With this in mind, we turn to the South African equity market and see that many stock prices on the JSE have moved below their long-term averages. The decline on the JSE All Share in the recent months have eroded price premiums with no material deterioration in the fundamentals (akin to a Black Friday sale). The JSE All Share P/E ratio reached a low of 14.3 in October 2018. With equity prices currently below their long-term averages, this indicates relatively lower prices.

It seems to be the opportune time to buy SA equities, so why are South African investors avoiding equities and looking to cash for returns? The SA equity market has experienced weak returns over the last few years. This, coupled with some major share crashes such as the Resilient Group and Steinhoff, has left investors feeling burnt and mistrusting. Loss aversion is a behavioural bias which explains that investors experience twice as much pain from a loss than the pleasure from an equal gain. As a result, investors would rather stay uninvested or in cash than take on the possibility of experiencing further losses. While cash may be a safer option, we need to remember that periods where equities underperform cash are temporary and equities remain the most reliable way of generating our return objectives in the long term, this being borne out by much evidence, locally and offshore, over a long period of time.

Being cognisant of our own behavioural biases goes a long way in helping to ensure that the actions you are taking are right for you and not those which can cause damage to your investment portfolio. If we give in to our behavioural biases and follow the crowd into buying or selling, or fail to invest out of fear of losses, we can significantly erode investment returns and even experience capital losses. Research has shown<sup>[1]</sup> that we can lose as much as 4% per annum from reacting to short term pricing behaviour (the buy high/sell low problem). Equity returns can be lumpy in the short-term, but investors should not concentrate on performance periods of less than 5 - 7 years. It pays to stay invested. This is a tough hurdle to meet for most investors, with the immediacy of 'now' preferred over the benefits of 'later' as another behavioural bias we tend to demonstrate consistently.

Over shorter time horizons market volatility can be disconcerting and frustrating to investors but now is not the time to be de-risking portfolios. Based on long-term averages, we can expect to see better return prospects in SA and offshore equities in particular.

If we invest at average prices we can expect to earn the average return for equities. This is a good outcome, and the basis of a good financial plan, where earning 'average' returns should be sufficient, and any excess returns a bonus.

Lastly, history also shows us that it does not pay to try and time the market, by switching between equities and cash. Equity returns are not evenly spread and single days in the market can be hugely significant to long term returns. For this reason, our general guidance is to remain invested, despite the bad news which will prevail much of the time.

While we may not be seeing quite the Black Friday levels we would prefer, there is certainly more to look forward to out of local equities for the first time in a number of years.

<sup>[1]</sup> The Dalbar investing study

data provided by Reuters and Datastream

30 November 2018

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
<b>LOCAL MARKET INDICES</b>									
FTSE/JSE All Share Index (ALSI)	ZAR	-12.6%	-12.3%	-12.6%	2.3%	5.5%	12.3%	10.9%	13.3%
FTSE/JSE SA Listed Property	ZAR	-5.5%	-24.5%	-21.3%	-2.9%	6.1%	12.7%	13.5%	13.2%
SA All Bond Index (ALBI)	ZAR	2.4%	7.1%	13.1%	8.3%	7.8%	8.3%	7.9%	7.3%
SA Cash Index (SteFI)	ZAR	1.8%	6.7%	7.3%	7.4%	6.9%	6.7%	0.2%	0.4%
Balanced Benchmark	ZAR	-8.4%	-4.4%	-5.2%	4.2%	7.4%	11.5%	7.2%	8.4%
SA Inflation (1 month lag)	ZAR	0.8%	4.5%	5.1%	5.5%	5.4%	5.3%	1.3%	1.3%
<b>GLOBAL MARKET INDICES</b>									
Global Equity (Datastream World)	USD	-5.7%	-0.7%	0.7%	9.1%	7.3%	11.5%	10.2%	14.2%
Emerging Markets Equity (Datastream EM)	USD	-5.4%	-12.0%	-8.8%	9.8%	2.3%	9.5%	15.2%	19.4%
Global Bonds (Barclays Global Bond Index)	USD	-1.6%	-3.2%	-3.0%	2.2%	0.1%	2.0%	5.2%	6.3%
Global Cash	USD	0.6%	2.1%	2.2%	1.4%	0.9%	0.7%	0.2%	0.2%
<b>MAJOR INDICES BASED TO RANDS</b>									
FTSE/JSE All Share Index (ALSI)	ZAR	-12.6%	-12.3%	-12.6%	2.3%	5.5%	12.3%	10.9%	13.3%
Global Equity (Datastream World)	ZAR	-10.7%	11.2%	2.3%	7.7%	14.1%	15.1%	14.8%	14.6%
Emerging Markets Equity (Datastream EM)	ZAR	-10.5%	-1.4%	-7.3%	8.4%	8.8%	13.1%	13.2%	14.1%
SA All Bond Index (ALBI)	ZAR	2.4%	7.1%	13.1%	8.3%	7.8%	8.3%	7.9%	7.3%
Global Bonds (Citigroup)	ZAR	-6.9%	8.5%	-1.4%	0.9%	6.5%	5.3%	14.0%	14.1%
<b>COMMODITIES</b>									
Gold (US Dollars)	USD	1.4%	-6.5%	-4.7%	4.7%	-0.5%	4.1%	13.1%	16.6%
Gold (Rands)	ZAR	-4.1%	4.8%	-3.1%	3.3%	5.8%	7.5%		
<b>CURRENCIES</b>									
Rand / Dollar	ZAR	5.4%	-12.0%	-1.6%	1.3%	-6.4%	-3.3%	15.3%	15.9%
Rand / GBP Pound	ZAR	7.1%	-5.6%	4.2%	6.6%	-1.2%	-1.4%	16.2%	15.8%
Rand / Euro	ZAR	7.9%	-5.6%	3.5%	-1.0%	-2.6%	-2.1%	14.2%	13.6%

Spot Rates		30-Nov-18	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
<b>CURRENCIES</b>							
Rand/US\$	Rand	13.87	14.15	13.64	10.17	10.07	5.69
Rand/GBP	Rand	17.69	18.45	18.44	16.65	15.47	9.40
Rand/EUR	Rand	15.70	16.44	16.27	13.84	12.77	NA
<b>RATES</b>							
Libor 6m \$	US\$	2.89	2.60	1.67	0.35	2.59	5.15
Repo Rate	Rand	6.75	6.50	6.75	5.00	12.00	19.73
Prime	Rand	10.25	10.00	10.25	8.50	15.50	23.50
All Bond Index Yield	Rand	9.61	9.65	10.01	8.39	NA	NA
<b>COMMODITIES</b>							
Gold (\$/oz)	US\$	1,219.15	1,191.49	1,279.13	1,253.35	812.65	292.35
Platinum	US\$	805.00	815.00	940.00	1,376.00	876.00	354.00
Oil (Brent Crude) \$	US\$	58.74	82.79	63.80	111.24	48.55	10.27
<b>INFLATION</b>							
SA Inflation	%	5.1	4.9	4.6	5.4	10.5	NA

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