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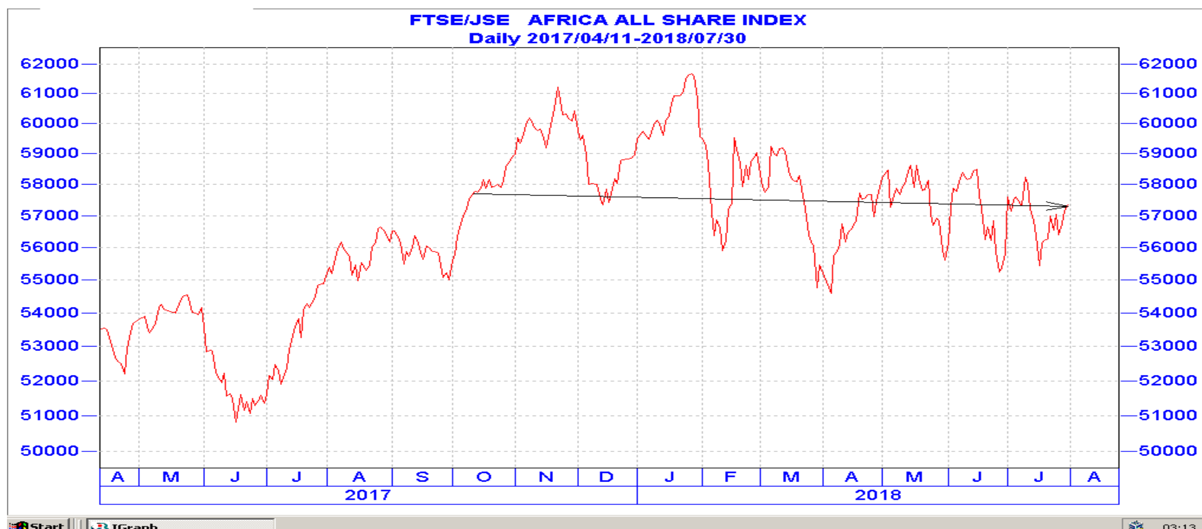
Challenging Conventional Wisdom

Four important principles of investing everyone should know

It's very easy, and very tempting, to focus on the markets, the economy, politics, manager ratings or the performance of individual funds. Most make this mistake, but this may lead you to overlook the basic principles that we believe can give you the best chance of long term success. Investing is by no means a piece of cake. It can be complex, and it's constantly shifting and changing. Looking at the below graph of the Johannesburg Stock Exchange over the past year or so clearly demonstrates this. Looking at the volatility (the up and down of the market) it is also clear for all to see that the market moved sideways the past 10 months or so.



But there are certain investing principles that will make it easier for you, whether you have R1,000 or R1,000,000 or more to invest – that is if you can stick to them.

Principle 1: Goals

Create clear, appropriate investment goals. The investment process begins by setting measurable and attainable investment goals and developing plans for reaching those goals. For example: do you know at what age you will like to retire, and do you know whether you will have enough to retire?

Common mistakes by investors include buying funds with good recent performance in the hope that it will continue or trying to time market peaks and troughs and buy and sell at exactly the right time. Avoid mistakes by working with a Professional Certified Financial Planner. Such a person can work with you through your current situation, setting some reasonable goals, along with a plan based on your unique circumstances. Remember failing to plan is planning to fail.

Principle 2: Diversification

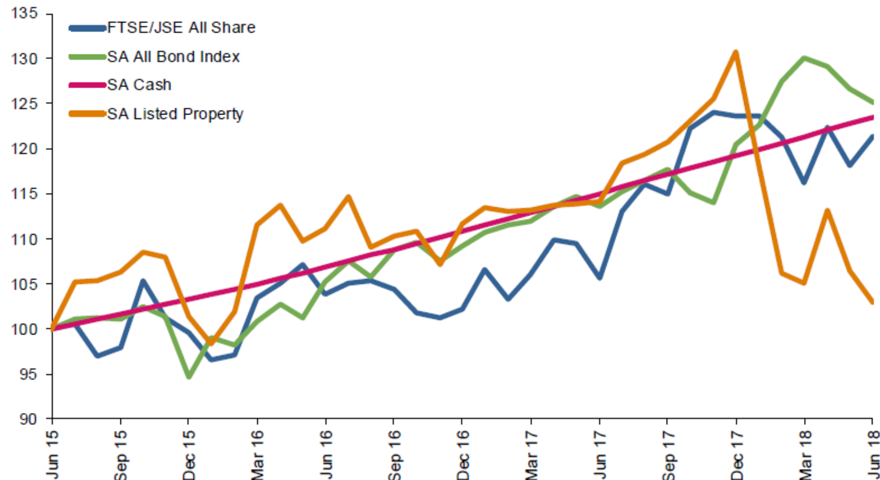
Develop a suitable asset allocation using broadly diversified funds. Different types of investments (assets classes) tend to have different levels of risk associated with them. Shares (equities) can be more high risk than bonds, for example.

The use of diversified investments helps to limit exposure to unnecessary risks. Remember the trade-off between risk and return, it's all about settling on the level of risk you are comfortable with. The below two graphs demonstrate this by comparing the FTSE/JSE All share Index, SA All Bond Index, SA Cash Index and SA Listed Property Index with each other. Look especially where shares and SA Listed property are in relation to SA Cash over three years and five-year periods respectively. Over the last three years cash was king during certain periods. Look for example what would have happened if your

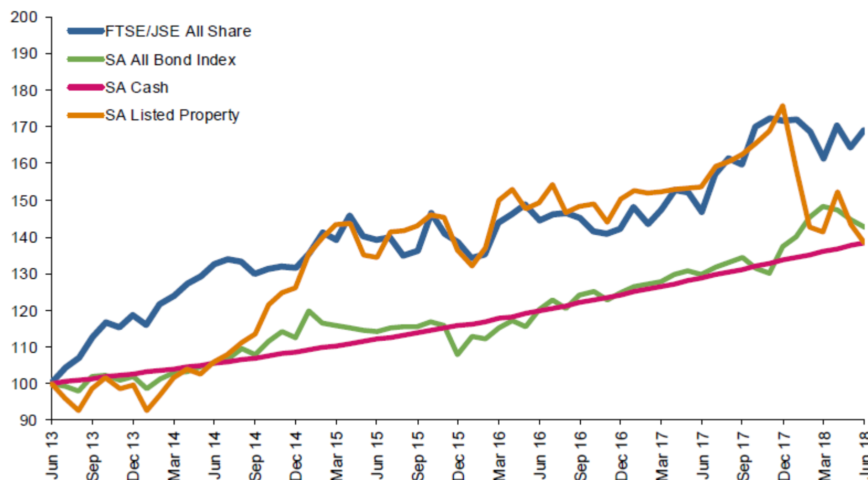
portfolio were just invested in SA Listed Property. This clearly underlines the importance of diversification.

SA asset class cumulative returns

3 years to 30 June 2018



5 years to 30 June 2018

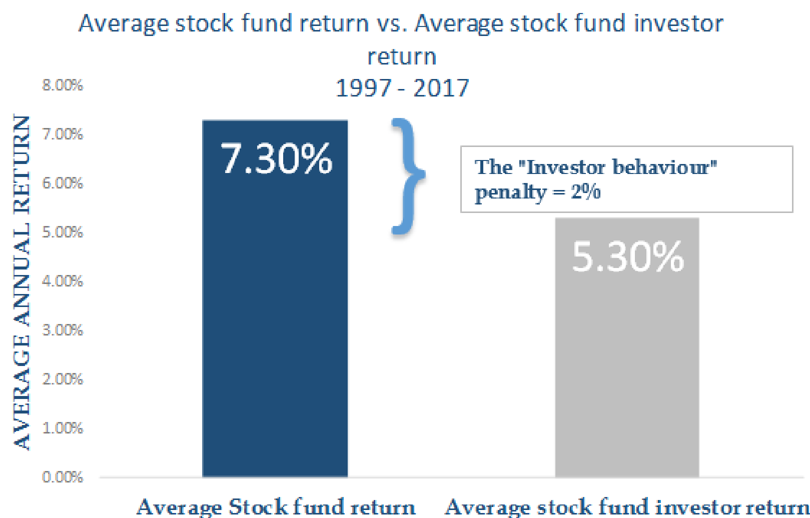


To summarise, make sure you don't have all your eggs in one basket (by investing in a diverse range of asset types including assets with offshore exposure). Diversifying can help spread your investment risk and your chances of benefitting from potential investment returns.

Principle 3: Invest for the long term

We are not talking savings here but investing to create wealth. Savings can be for the short term. Jumping in and out of the market can lead to missed opportunities. Carl Richards, a Certified Financial Planner™ and creator of the Sketch Guy column appearing weekly in the New York Times, demonstrated this so accurately.

A study by Dalbar in the USA of all the equity funds in America over a 20-year period showed that your average return would be 7.30% per annum. However, investors (professionals as well as individuals) only achieved a 5.30% growth per annum over the same period. The biggest reason for this discrepancy is that investors constantly change their investments at the worst possible times.



Investing evokes emotion that can disrupt the plans of even the most sophisticated investors. Some make rash decisions based on market volatility. But you can counter emotions with discipline and a long-term perspective.

Principle 4: Costs - Minimise cost

You cannot control the markets, but you can control how much you pay to invest. Every Rand that you pay in costs and charges comes directly out of your potential return. Indeed, research suggests that lower-cost investments have tended to outperform higher-cost alternatives. Therefore, the lower the investment costs, including investment management charges, advisor charges, administration charges and other charges, the higher the potential net return for you as the investor.

Drafted by Verso Wealth

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