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Diversification across different asset classes is a sound strategy for avoiding overexposure to one asset class.

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4 DANGER SIGNS SA INVESTORS NEED TO LOOK OUT FOR

By Maria Smit, Financial Advisor Brenthurst Wealth Pretoria

Between rampant crime, loadshedding and record unemployment, South African investors have quite a few things keeping them up at night. The last thing they want to worry about is their [retirement savings](#), but that's not a luxury we have.

There are many factors and forces that influence the short-term fortunes of the stock market, and many of those factors are top of mind for local investors trying to secure a comfortable retirement.

With that in mind, here are four of the biggest concerns that South African investors have, and how to avoid or mitigate these risks.

1. INFLATION

Inflation is on the rise globally and domestically is threatening to upset an already wobbly appletart.

The big danger here is not only that your buying power is being eroded, but that your investments may struggle to beat inflation. This is particularly dangerous if, like many South African investors, you've decided to avoid risk by switching to less volatile money market funds.

The biggest problem with this strategy is that these low-volatility assets are also low-return assets. And with inflation rising, you run the risk of your returns underperforming against inflation over the long term.

WHAT CAN YOU DO? An effective strategy is to diversify your portfolio by categorising your investments according to their purpose. For instance, if you have a long-term horizon of five or more years, then you can take on more risk because you'll be able to ride out short-term volatility.

However, if you're going to need some of your funds in the next year, then it's probably best to hold that in the money market until you need it.

2. A MARKET CRASH

The fear that the market may crash is understandable, if not entirely logical. History tells us that markets can fall spectacularly, like in 1929, 1987, 2001 and 2008. Let's not forget March 2020 either, when global markets fell as much as 30% as COVID-19 lockdowns halted the world economy.

Fear of losing their savings in another big crash has driven many South Africans into less risky assets.

What's important to appreciate is that it's not uncommon for volatile (and therefore risky) assets to show a downward movement over a month or two. Sometimes this can be for as long as 12 months before the price picks up again. This is why we insist that if you're invested in high-risk assets, like listed shares, then you need to hold that investment for at least five years, if not longer. This time horizon allows the short-term dips in your investment to fade into the distance as the price inevitably climbs over time.

This is illustrated perfectly in the two below graphs. In the first graph the movements appear quite dramatic, but that's only over a month. When you look at that same graph over a five-year period you can see that the volatility smooths out, and what seemed a big movement is nothing more than a blip on the graph.

MARKET MOVEMENTS OVER 1 MONTH



MARKET MOVEMENTS OVER 5 YEARS



WHAT CAN YOU DO? The best advice I can give is to ignore the short-term movements in your portfolio. Tracking progress every day of the week can be emotionally exhausting.

3. MARKET VALUATIONS

After inflation, inflated stock prices are the next biggest threat for South African investors. And not for the reason that you may think.

The danger in higher prices, which contributes towards a higher price-to-earnings ratio, is investor reluctance to enter the market.

Many local asset managers have been telling their clients that South African shares are cheap, certainly comparable to some offshore assets, and that it's a good time to invest locally. However, I question the sense in this if you consider the negative impact from domestic pressures like constant loadshedding, political instability and a volatile rand.

WHAT CAN YOU DO? Rather than staying out of the market in anticipation of a correction that will lower the price of offshore assets, I suggest that you phase your funds into the market instead of investing a lump sum at once. This should mitigate the risk of trying to time the market, and as a result not investing.

If you're sitting on a pile of cash from an inheritance, sale of a property, or from selling out of the market, consider implementing this strategy to get your money back to work. Statistically you have a higher probability of success if you invest it all at once, but regret aversion is a powerful force, so this is your next best option.

4. HIGHER INTEREST RATES

It's only natural that fear of higher interest rates goes hand-in-hand with the worry of inflation. Central banks tend to fight inflation by raising rates, which we saw the SARB do in November this year, with signs that developed market banks will follow suit.

Higher rates are not, however, always bad for your investment portfolio. For instance, higher rates often lag inflation and the act of raising rates can at times halt inflation.

Also, rising rates force stock prices lower because corporate earnings will be lower, due to subdued demand. And as interest rates rise, the cost of borrowing becomes more expensive, meaning demand for lower-yield bonds will drop, causing their price to drop.

WHAT CAN YOU DO? One strategy to counter the impact of rising interest rates is to consider a flexible fund. This is because the fund manager has the option to invest in shares or money market instruments. By the same token, sufficient diversification across different asset classes is a sound strategy for avoiding overexposure to one asset class.

MARIA SMIT IS A FINANCIAL PLANNER AT BRENTHURST WEALTH PRETORIA. maria@brenthurstwealth.co.za
Phone: +27 12 347 8240 | Mobile: +27 79 696 6860

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