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If your money is lying in an offshore bank account earning nothing, you are missing out.

And fixed income investors have better yield options than they've had in years – this includes the local SA market.

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PAST PERFORMANCE IS UNEMOTIONAL, HUMANS AREN'T

STUDYING THE PAST CAN'T HELP YOU PREDICT THE FUTURE, BUT IT CAN PROVIDE CONTEXT IN TERMS OF THE RELATIONSHIP BETWEEN RISK AND REWARD.

By Arin Ruttenberg — Financial Advisor, Brenthurst Wealth Sandton

I was listening to a podcast the other day and one of the participants said something very interesting: "Diversification is about learning to hate part of your portfolio".

This got me thinking about how, since early 2022, you would dislike your higher duration growth stocks, but love your value stocks. Our human emotion and diversification are the only things we have control over, not the market. How we react in this day and age with market data and news in the palm of our hand, is what matters more than it ever has.

The 1987 crash looks like a blip on a long-term stock market chart, but at the time, it felt like the second coming of the great depression to investors. **With the benefit of hindsight, every crash in history looks like a wonderful buying opportunity. No one knows when it will end in real-time.**

My biggest takeaway from these back tests or hindsight moments is the need for diversification in your holdings and asset allocation to ensure the winners are part of your portfolio. It is much easier to pick the losers than the winners. Only a handful of winners make up the returns of an index. Studying the past can't help you predict the future, but it can provide context in terms of the relationship between risk and reward.

An understanding of the risk and return profiles of stocks, bonds and cash can help you determine the right asset allocation for your specific needs and goals.

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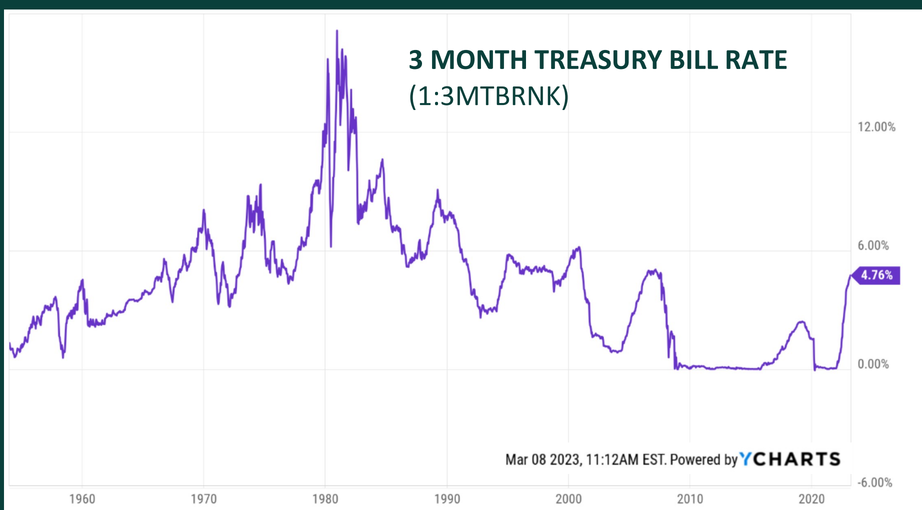
For example, we are currently looking at 5% yields across the board for short-term government bonds in the US. Some people, me included, will continue to remind you that inflation is still 6% in the US, but let's be honest: right or wrong, most investors think in nominal terms, not real. Short-term yields have been on the floor for so long that 5% interest rates are bound to grab the attention of investors.

For a few years, rates were so low many investors were being forced out on the risk curve. I know plenty of balanced investors who preferred a 60/40 offshore portfolio, but opted for a 70/30 or 80/20 mix because bond yields were so pitiful. The good news about 5% bond yields is that more conservative investors no longer have to stretch on the offshore side. Your expected returns are obviously much better when yields are at 5% than when they are at 1% or less. **Your asset allocation can change for any number of reasons: your financial circumstances or goals could change, your willingness, need or ability to take risk could change and the markets could change.**

But there is an important distinction between an asset allocation decision based on risk vs reward trade-offs and market timing. The biggest problem with making a huge shift in your portfolio from stocks to cash is that short-term interest rates are fickle.They can go up quickly, but also drop in a hurry.



Short-term bond yields could stay elevated for a while if the economy and inflation remain strong and the Fed battles high inflation.

BUT WHAT HAPPENS IF/WHEN SHORT-TERM RATES GO BACK DOWN?

If the Fed keeps raising rates, it will eventually slow things down.

Once inflation slows and the economy weakens the Fed is going to cut rates. Unfortunately, T-bill yields won't be 5% if inflation is 3%. Today's 5% yields aren't going to last forever.

I don't know what's going to happen in the short-term when it comes to interest rates or the stock market. No one does, not even the Fed.

I prefer to make investment decisions based on my risk profile and time horizon, rather than try to make forecasts about what will happen next. In the short run, cash and bonds can offer stability and short-term to medium-term savings goals.

Over the long run you'll barely keep up with inflation, especially with cash. In the short run, stocks can rip your heart out. In the long run the stock market remains the best bet for beating inflation and compounding your wealth. The best-case scenario would be you moving some or all of your portfolio into cash, the stock market drops, you clip your 5% and miss out on some losses, then shift back to stocks when yields fall.

The worst case is, you move some or all of your portfolio into cash, yields fall, the stock market rips, you miss out on the gains and now you're stuck in an asset class with low expected returns. Don't get me wrong, I like the idea of taking advantage of 5% yields. If your money is lying in an offshore bank account earning nothing, you are missing out. And fixed income investors have better yield options than they've had in years – this includes the local SA market. I'm not trying to talk anyone into or out of any asset class, but what I'm saying is, educate yourself around asset classes.

Cash – locally or offshore – has a place in a portfolio for short-term liquidity needs and stability.
Bonds have a place in a portfolio to provide income and protection against deflation and disinflation.
Stocks have a place in a portfolio to provide higher expected returns and protection against the long-term impacts of inflation. There are also different types of stocks between which you can diversify, namely quality, value and growth which will all behave differently during different market cycles. Having the knowledge to understand that will help you build a well-diversified portfolio.

I just think it's difficult to constantly shift your asset allocation into and out of these asset classes without causing some harm to your investment plan. Asset allocation is for patient people and the only thing to help keep your emotions in check. Remember, it's OK to dislike part of your portfolio – that part will most likely be your most liked part sooner or later. Aligning your asset allocation with your risk profile, current circumstances, time frame and unique needs is what matters, and if you still don't understand how this works, speak to a qualified professional.

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ARIN, based in Brenthurst Wealth's Sandton Office, has been working in the financial services industry since 2013.

With experience at Investec, Momentum Wealth International and Brenthurst Wealth Management, he brings a wealth of expertise as a financial advisor.

He has been at Brenthurst since 2016 and holds a BCom degree and a Postgraduate Diploma in Financial Planning from the University of the Free State.

Arin's passion for financial planning drives him to continuously expand his knowledge, ensuring he can assist clients in achieving their financial goals. He has successfully completed the First Level Regulatory Examination for Representatives, enabling him to provide comprehensive investment advice.

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