INVESTMENT REPORT

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THE BOTTOM OF THE MARKETS: ARE WE THERE YET?

WE ARE CLOSER TO BEING AT THE BOTTOM OF THE MARKET THAN WE WERE LAST YEAR THIS TIME.

By Ruan Breed, Financial Advisor at Brenthurst Wealth Stellenbosch

Instant gratification – something that most of us simply cannot live without. This trait surfaces in a lot of areas in our lives, whether it be in our relationships, careers or finances – the list is never-ending. One area of our lives where this is probably most prevalent is in our personal finances and, even more so, investment portfolios.

You allocate your capital to an investment and the first thing you want to know before the transaction is even complete is: "How much money did I make?" or "How much money will I make?" Instant gratification is probably one of the biggest traits causing the downfall of many investors because, believe it or not, waiting essentially helps you as an investor. But many people detest waiting. Charlie Munger said: "If you didn't get the deferred-gratification gene, you have got to work very hard to overcome that."

The other scapegoat for the irrational behaviour of investors is fear. As we all know by now, people react in one of three ways when facing fear: flight, fight or freeze. Unfortunately, the first option is normally the one opted for by investors, whereas "fight" has historically (and statistically) led to better results for investors.

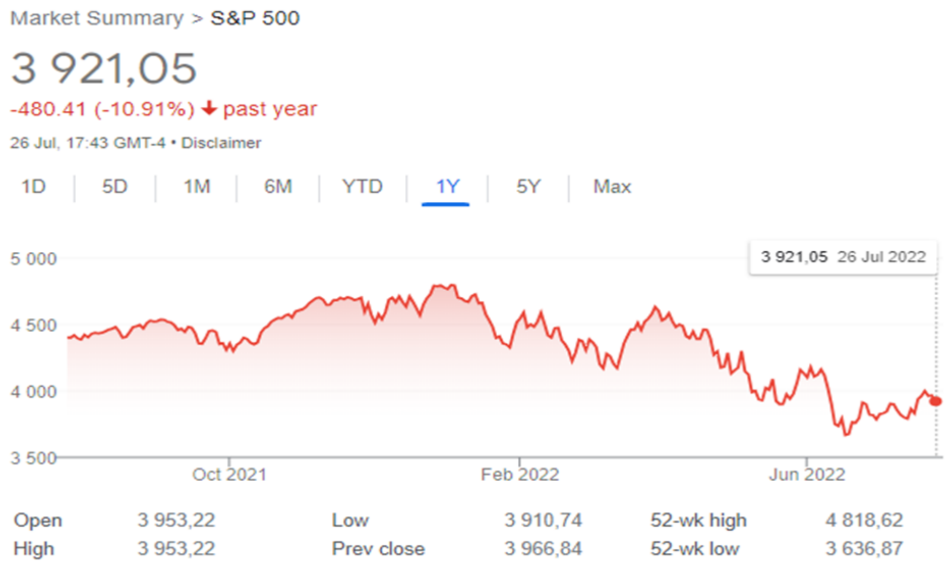
It should be remembered that only fear sells and only fear drives reaction. Thus, the news headlines will ***always*** be fear-driven, as this is what stimulates a response.

Fortunately for all patient and neutral investors, the market is ahead of the news, and by the time the headlines reflect the fear and failure, it would already have been priced in. It is, therefore, of extreme importance to have a forward-looking viewpoint when decisions are made regarding your investment portfolio.

THEREFORE, THE QUESTION REMAINS:
HOW DO WE KNOW WHEN MARKETS BOTTOM AND, IN TODAY'S TERMS, ARE WE THERE YET?

Trying to time the market is a fool's game, but by having the required futuristic outlook and analysing the data, some conclusions can be drawn, and to a certain extent, sense can be made as to where we are in the market. But before we look at the data, one thing is certain: *we are closer to being at the bottom of the market than we were last year this time.* **Below is a simple graph of the S&P 500 Index indicating exactly that.**

MARKET SUMMARY S&P 500



Source: S&P 500 Data as at 26 July 2022

It is almost too simple for this statement to make sense. We do not know for a fact when or where the market will reach its ultimate bottom, but what you can be 100% sure of is that we are closer to the market bottom (irrespective of what level this may occur at) than a year ago, and we are further away from another all-time high than we were a year ago.

WHY THE STATEMENT, AND WHAT DOES THIS MEAN?

The answer is simple: the difference between the levels of the market at this given point in time is the margin where the opportunity lies for new (and existing) investors. If you were happy to move capital into the market at, basically, any stage up until December 2021, you would (and should) be more than happy to move capital into the market at current levels. Because one fact remains – the market will reach another all-time high again.

LET'S MAKE THE DATA DO THE TALKING – GLOBAL MARKETS AND THE ROAD TO (OR FROM) THE BOTTOM

OFFSHORE

People are currently (but generally always have been, and always will be) negative. Really and truly negative. The question now is whether that could possibly be a good thing.

It is not a common occurrence for large fund managers to be overweight bonds relative to equities. This suggests deep negativity for the short-term outlook of the economy. The latest edition of Bank of America's monthly survey of global fund managers found that they are now even more underweight stocks than bonds than they were in March 2009, which is the same month the stock market hit rock bottom after Lehman Brothers collapsed.

EQUITY ALLOCATION VS BONDS LOWEST SINCE APRIL 2009

NET % OW EQUITIES VS BONDS

Source: BofA Global Fund Manager Survey

On the one hand, this is terrible news. The asset managers who deploy capital for long-term growth think it is better to lend money to the government (still at very low presumable rates) rather than to take a share of the profits of big and established companies.

But on the flip side, and as I mentioned above, an opportunity might be (and possibly is) banging on the front door. Below is an indication of how stocks have performed since the beginning of 2009.

TIME TO BUY STOCKS?
The last two times bonds were overweighted, stocks enjoyed big rallies

Source: Bloomberg

On the previous two occasions where asset managers went overweight bonds to stocks (2009 Global Financial Crisis and initial Covid lockdowns in March), the market turned around without any warning or good news-flashes on the front pages.

On the contrary, only doom and gloom were still to be found during these times, yet these were both excellent opportunities to go long on stocks due to the deflated levels of the markets at the time. Investors were presented with an opportunity to enter the market at favourable levels.

A further survey by the Bank of America, aimed at some of the largest asset managers around the world, found that most of these managers have now (up until June) taken a lot of risk off the table by moving largely out of equities and into bonds, as mentioned above. The net % of managers taking higher than normal risk levels has reduced significantly in the last six months, below levels seen in the Global Financial Crisis.

CHART 13: WHERE'S LEHMAN?

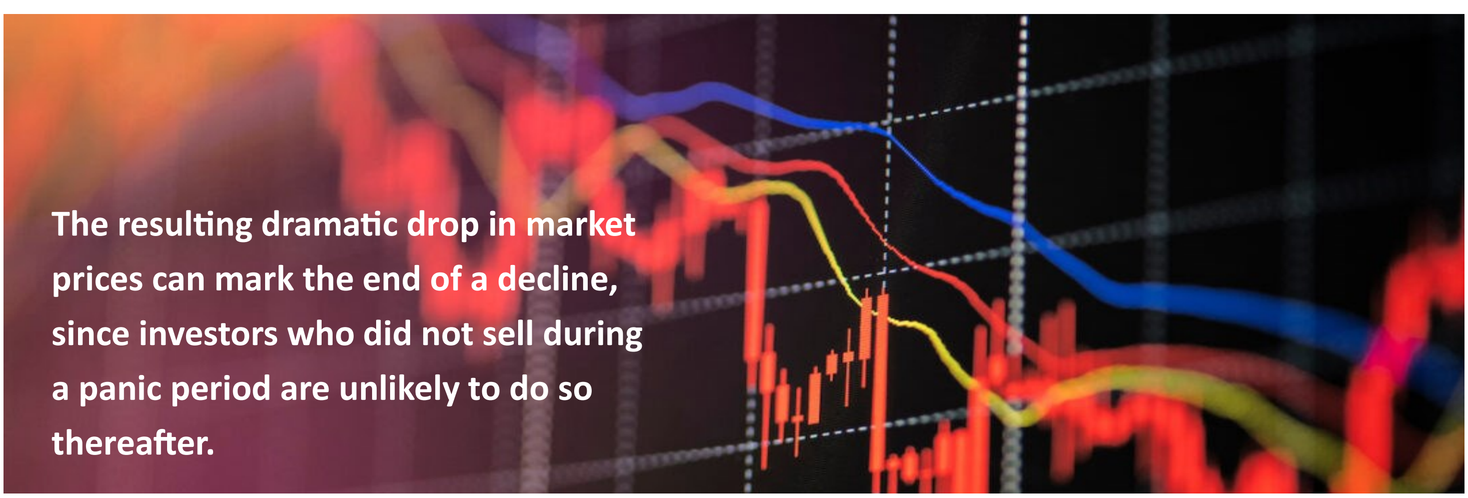
Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

I know the voice in your head is screaming that this is very bad news. It was, yes, back in December. But once again, this data is evidence that, overall, the market has already taken more than enough evasive action and that we might be reaching full market capitulation. (Capitulation is the extreme increase of selling pressure in a declining market. The resulting dramatic drop in market prices can mark the end of a decline, since investors who did not sell during a panic period are unlikely to do so thereafter.)

WHAT IS THE BEST STRATEGY IN A DECLINING MARKET, WITH THE BOTTOM EXPECTED TO BE CLOSE?

In layman's terms, the best thing you can do during these times, and continue doing, is to contribute money towards your investments, effectively buying shares each month at a cheaper price than the month before. I will explain this using a simple example by comparing an investment which has experienced a market dip whilst receiving contributions with an investment which did not receive contributions through the course of the market drop.



Let's assume a share is worth R1. The share has three months of bad performance followed by one month of good performance, resembling a short market downturn and then a bounce back.

MONTH 1: - 6%	MONTH 2: - 8%	MONTH 3: - 13%	MONTH 4: 30%

Investment 1: Starts with R50 000 with further R10 000 p.m. contributions.
Investment 2: Starts with R50 000 with zero future contributions.

	Monthly performance	Share Price	Shares Held : Investment 1	Investment 1 (Getting Monthly contributions of R10 000pm)		Shares Held: Investment 2	Investment 2	
Initial Investment		1.00	50000	R	50,000.00	50000	R	50,000.00
Month 1	-6%	0.94	60638	R	57,000.00	50000	R	47,000.00
Month 2	-8%	0.86	72202	R	62,440.00	50000	R	43,240.00
Month 3	-13%	0.75	85493	R	64,322.80	50000	R	37,618.80
Month 4	30%	0.98	95717	**R**	**93,619.64**	50000	**R**	**48,904.44**

- ☑ **INVESTMENT 1 grew to R93 619.64 because it continued to receive contributions monthly, thus buying new shares at a lower price each month. Then, when the upturn came, Investment 1 had more shares from which to generate growth than Investment 2.**
- ☑ **INVESTMENT 2 ended on R48 904.44 after 4 months, thus not even recovering to its initial investment value of R50 000.**

The conclusion is exactly that which Warren Buffet alludes to in all his books. He made most of his wealth being invested and contributing throughout the biggest market crashes in history, including World War II where he made most of his initial wealth by buying stocks which were declining each month.

THE RESULTING SUMMARY

It is impossible to time the markets, but by having an in-depth look at some of the (even gloomy) data, one might be able to get a clearer picture of the markets and the way forward. If you take a close look at the data above, you will clearly see that a lot of fear is already priced into the markets – the war, inflation, Covid, supply chain pressures, etc. What is more important, is that the biggest percentage of large global asset managers have already made the moves from growth assets (equities) to risk-averse assets (cash and bonds).

Why am I restating this? The reason is simple.

If you try to make the same changes in your own portfolio or continue holding on to cash during this macro-economic environment, you might (and soon will) miss the opportunity presented to you as an investor. Once the market has turned for the better, you will still be sitting on the side-lines asking questions such as: "Isn't the market too high for buying?"

Markets are forward-looking and require investors to have the same sentiment. If you are investing capital based on only existing/current market factors, you will have the urge to make switches daily. The importance of having a forward-looking approach cannot be emphasised enough.

The fact remains, we cannot time the markets and predict the exact bottom, but we are closer to the bottom and further from the top than we were a year ago. This is where the opportunity lies, and it is still on the table…

ADVISOR PROFILE

RUAN BREED | FINANCIAL ADVISOR AT BRENTHURST STELLENBOSCH

BCom. Fin Science | CIMA Adv Dip MA | PGDip Investment Planning

Ruan joined the Brenthurst Wealth Team in 2021 as an advisor/paraplanner and currently works under the direct supervision of Sonia du Plessis and André Basson in our Stellenbosch office.

He obtained his BCom (Financial Sciences) degree at the University of Pretoria in 2018. Consequently, he also enrolled with CIMA (Chartered Institute for Management Accountants) as a prospective CGMA candidate and will complete all the relevant CIMA exams.

He is also currently studying towards his Diploma in Investment Management at the University of the Free State.

Ruan's previous experience includes "tax and advisory" at Crowe Tax and Advisory Services in Stellenbosch.

Email: ruan@brenthurstwealth.co.za | Phone: +27 21 882 8706 | Mobile: 082 551 3299

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