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THE FINANCIAL ADVISOR MANTRA: DIVERSIFY, DIVERSIFY, DIVERSIFY

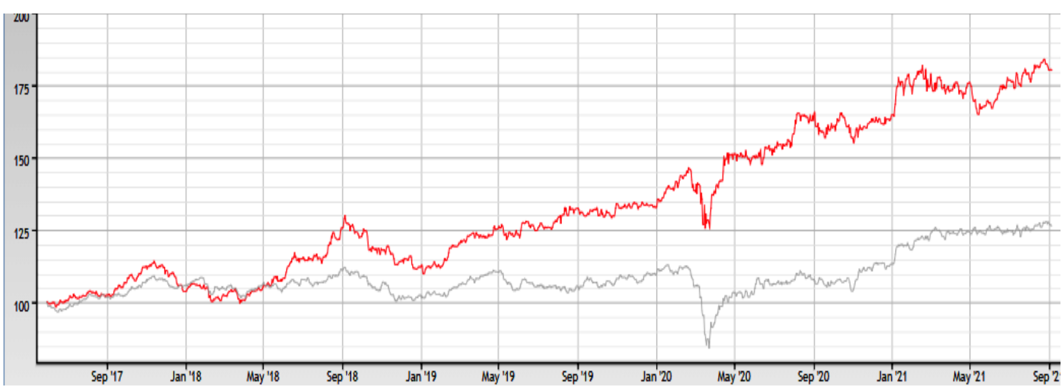
By Gustav Reinach, Financial Planner, Brenthurst Wealth Management

One of the most important goals for any investor is to avoid losing money, which can be done easily enough if you lower your risk. However, investing only in low-risk assets will deliver below par performance and possibly lead you to missing your investment goals.

Which is why you'll hear advisors, like myself, repeating the same old mantra: diversify, diversify, diversify.

What this does is spread your risk across different asset classes so that, if done properly, one asset class will outperform when others underperform.

Take this example of the performance of two different funds between June 2017 and September 2021.



The red line represents the returns of a fund that has 50% exposure to international equities, whereas the grey line is that of a fund with 50% – 60% exposure to SA equities.

With annualised growth of almost three times that of the SA-focused fund, diversifying offshore has been hugely beneficial.

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DIFFERENT STROKES

A common misconception about diversification is that simply spreading your risk across multiple asset classes is enough. However, every portfolio and diversification strategy will differ, based on each individual investor's needs and priorities and crucially, your investment horizon.

I believe that if you have 10 or more years before you need your capital then there's no reason why you shouldn't be 100% invested in equities.

Your diversification strategy, in such an instance, would then focus on divergent sectors or themes, as well as different geographies. As the above graph illustrates, having just 50% of a portfolio invested in offshore markets remarkably outperforms locally-focused strategies.

The closer you are to retirement, the less risk you want to take in case markets hit a speed bump.
This can have a disastrous impact on your investments if you don't have sufficient time before retirement in which prices can recover.

I recommend that if you are five or less years away from retirement you can start tapering your exposure to equities to the point where you have approximately 70% of your portfolio in cash and bonds.

For shorter investment horizons – if, say, you're saving for a deposit to buy a house in three years' time you would also want to diversify your portfolio. Once again, I suggest a maximum of 30% in equities and the remainder in cash and bonds.

DIVERSIFICATION WITHIN ASSET CLASSES

As already mentioned, 100% exposure to one asset class, like equities, makes sense under certain conditions. It makes most sense at times when you have a long investment horizon, which would allow you time to recover after market dips.

Apart from diversifying across sectors, you can get further diversification by investing offshore. I believe that this is essential for South African investors for long-term outperformance.

The wider scope of investments and investment opportunities outside of the country, alone, is reason to spread your risk across borders.

DON'T DISCOUNT SA BONDS

I'm certainly not advocating that you abandon all local assets, because there is still value to be found. Particularly in local bonds.

We are still comfortable with SA bonds because, in real terms, they deliver the best yields for what is a conservative asset class. In addition, they are a great combination with offshore equities because they are negatively correlated.

This provides the ideal counterbalance in a portfolio that ends up giving you a smoother ride over the longer term.

MONEY MARKET AND CASH

Conservative assets, like cash and money market, investments, are less popular because of the effect of inflation eating into your capital.

It makes sense to have some liquidity in local currency, if that suits your lifestyle, but I would suggest holding no more than 8% – 10% of your portfolio in cash. Having cash on hand also presents the opportunity to profit from cheaper priced equities, should there be a big market correction.

If you're inclined that way, you might want to set aside some liquidity with which to take a punt on occasional opportunities. This approach doesn't suit everyone, but does encourage the more adventurous investor to keep some money available for investing without the fear of upsetting their entire portfolio with a longshot side bet.

GUSTAV REINACH IS A FINANCIAL ADVISOR AT BRENTHURST PRETORIA.

Phone: +27 12 347 8240 | Mobile: +27 83 267 5329 | Email: gustav@brenthurstwealth.co.za

GUSTAV joined Brenthurst Wealth in 2018 and is currently based in Pretoria (Gauteng) as a Financial Advisor.

He obtained a B.Com Economics degree from the University of the Free State with focus on key subjects such as Investment Management and International Economics.

Gustav successfully completed his First Level Regulatory Examination for Representatives, which enables him to furnish advice to clients on all investment related matters.

Gustav's previous experience includes the analysis of white label and hedge funds, as well as financial planning for individual clients focusing on their investment portfolios. He is qualified to advise clients on all investment related matters, focusing on investment planning, retirement planning as well as offshore investments.