An investment plan of action

By Sonja Saunderson, Chief Investment Officer at Momentum Investments

Sticking to a healthy diet is good for you. Having an exercise plan and sticking to it is good for you. We all know that, right? So why can't we stick to an investment strategy?

We will remember last year's investment markets for volatility, uncertainty and at times, pure mayhem. Covid-19 has undoubtedly made it difficult for any investor not to question their investment strategy. And yet, 2020 has again proven just how difficult it is for investors to stick to their strategy. But what is an investment strategy?

At its most basic level, it is a plan of action that guides an investor's goals based on the outcomes required, the risk appetite of the investor and the timeframe to achieve the goal. The financial plan is usually formulated based on a cash flow analysis or needs analysis together with a financial adviser who understands realistic market assumptions and risk behaviours and who has the tools to model these under different scenarios.

For the professional investor, it is similar but articulated and rooted in their belief of what drives markets, what persistency there is in any particular driver and how to consistently exploit that behaviour.

All while taking a calibrated risk management approach into account, whether risk is volatility, capital losses, market relative risk or other risks they deem appropriate according to their belief system.

Our outcome-based investing philosophy informs our strategy. This investing approach is a belief system defining the way we manage and grow our clients' investments. Investing is personal and we understand that a client's investment isn't just another investment.

It's unique to them. We define pre-determined risk targets, implied return target and realistic timeframes of a client reaching their goals. Each investment decision is then evaluated against this framework.

There are many other examples of investment strategies, but they all have one thing in common – they are all based on how much one is willing to lose. Or simply put, what is the risk consideration in the investment strategy. If the strategy is based on the critical risk consideration, then theoretically you should not have to change your strategy during volatile markets.

Your risk appetite has not changed, so why should your investment strategy? And yet, investors do change strategy during market turmoil. Why is that?

There's a link between risk and returns. The lower the risk, the lower the potential return. The more risk you take on, the higher the potential return. Humans are driven by greed and fear. When the news gets bad, we panic, and we sell. When the market is doing well, we buy again because we get greedy. And this costs us over the long term.

Many research studies have time and again proven just how harmful this switching behaviour can be. Our research shows the penalty of this behaviour is that as much as a third of portfolios can be sacrificed over time – a staggering number. How do we stop this from happening?

Firstly, if you want to give yourself a fighting chance of success at investing, you need to have a strategy and stick to it.

When it comes to a successful investment strategy, it is worthwhile remembering the following:

- Remember the big picture and why you formulated the strategy in the first place. Go back to this plan and its assumptions to reassure yourself if you need to. And do not invest in something you do not understand.

- Don't second guess your plan without enough evidence. Write it out, communicate it to someone and check if it still makes sense. Be pragmatic in re-assessing it with help but do not waiver without grounded reasons.
- Be resilient to adapt the plan as the environment or your circumstances change. The best investment strategy is robust over cycles, not necessarily the best in every cycle.
- Don't listen too much to the fearmongers. Sometimes tuning out the noise can protect you more than getting every investment decision right.
- Remember that the herd isn't necessarily right. And in investments they're usually not.

We keep to our outcome-based investing philosophy that places the client's goals at the centre of the investment process.

It's about maximising the probability of a client achieving their unique goals, ensuring portfolios remain flexible, adaptable and diversified, ensuring an attractive risk-adjusted return that provides a more consistent investment experience over time, and limiting the risk and temptation of market timing.

The art of investment strategy

By Moosa Hassim, Investment Analyst at Old Mutual Wealth Private Client Securities

From a pure investment perspective, if 2020 and the beginning of 2021 have taught us anything, it is that having a defined investment philosophy and strategy is as vital as ever.

Simplistically, an investment strategy guides an investor's decisions based on objectives, risk tolerance and future needs for capital, and when combined with a proven investment philosophy and process, can help investors maintain perspective during periods of market turmoil.

Last year was marked by extreme market volatility driven by the outbreak of the COVID-19 pandemic. At the same time, the beginning of 2021 showed how coordinated investor behaviour can profoundly impact the price of securities and news headlines.

To look through these events and achieve sustained long-term investment returns, an investor needs to establish an investment strategy and process that can separate the "noise" from actual investment signals This is because being a successful investor is less about being smart or right and more about following a sound investment strategy and remaining invested, despite how one may "feel" about markets.

TIME IN THE MARKET VS TIMING THE MARKET

Over the long term, the stock market historically reflects the macroeconomy's objective performance and the individual companies within that economy. Over the short term, however, the stock market often reflects human emotion, perceptions and misperceptions.

Benjamin Graham summed this up very well: "In the short run, the market is a voting machine, but in the long run, it is a weighing machine."

It appears that managing market risk is much more about remaining invested rather than trying to time the market. The chart below illustrates this point by showing how exiting the market during periods of heightened volatility could result in investors missing the upside that inevitably materialises.

Our research shows that if we miss just the top 10 performing days per decade, the annualised return would be almost half that of the market return.

Performance Comparison	20 Year CAGR
S&P 500	12.93%
S&P500 excl. top 10 days per decade	7.41%