BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

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JUNE 2010 • ISSUE 91

HOW TO BECOME A BETTER INVESTOR

By Magnus Heystek –Investment Strategist

One of our biggest functions at Brenthurst Wealth is to teach our clients how to become better investors. We consider this to be one of our top priorities as better investors become wealthier over time. Even a small improvement in annual returns translates to a substantial difference in total capital values over time.

A small difference in annual investment returns might not seem important but over longer periods of time the difference can be quite staggering. At Brenthurst Wealth we understand the importance of providing our clients with maximum returns with the lowest level of risk.

Many international studies have shown that individual investors invariably under-perform their respective benchmarks. The same holds true for South African investors.

They get into markets close to the top and take money out at the bottom, moving from one asset class to another in a desperate chase for performance, often abandoning certain asset classes just before they take off in order to put money into another asset class just before it peaks.

The problem is further exacerbated by the fact that many people retiring out of pension funds are confronted with the bewildering choice of investments for the first time in their lives. Mistakes are common which could lead to a massive wealth-destruction in a very short space of time.

Take for example an investment of R1 million invested over the following period.

COMPOUND INTEREST	PERIOD IN YEARS				
	5yrs	10yrs	15yrs	20yrs	25yrs
8%	R 1,469,328.07	R 2,158,924.99	R 3,172,169.11	R 4,660,957.14	R 6,848,475.19
10%	R 1,610,510.00	R 2,593,742.46	R 4,177,248.16	R 6,727,499.94	R 10,834,705.94
12%	R 1,762,341.68	R 3,105,848.20	R 5,473,565.75	R 9,646,293.09	R 17,000,064.40
14%	R 1,925,414.58	R 3,707,221.31	R 7,137,937.97	R 13,743,489.87	R 26,461,915.81

Continued on page 2...

In this issue

BECOMING A BETTER INVESTOR : 2

- CONTROL YOUR EMOTIONS
- STAY THE COURSE
- DEFINE YOUR INVESTMENT OBJECTIVES
- UNDERSTAND THE PROCESS

PSYCHOLOGY OF BAD INVESTMENTS: 3

- ANCHORING
- REGRET AVERSION
- OVERCONFIDENCE
- HERD BEHAVIOUR

CONTACT US 4

Global Markets
AND SA ECONOMY

TO CREATE LONG-TERM WEALTH YOU NEED TO ACCEPT SOME DEGREE OF RISK.
THE BIGGEST RISK OF ALL IS NOT TO TAKE ANY RISK AT ALL.

THE GREATEST CONTRIBUTION WE CAN MAKE AS INVESTMENT ADVISORS
IS TO TRY AND ACHIEVE THE HIGHEST POSSIBLE RETURN
WITH THE LOWEST POSSIBLE RISK.

Continued…

We often see examples of rear-view investing in SA. An analysis of the inflow of retail funds into collective investment schemes shows investors often flood to investment sectors or funds AFTER they have already shown good results (often encouraged by selective advertising) only to switch out at the bottom when the boom invariably turns into dust.

Not only is this costly in terms of fees, commissions, taxes & re-entry fees, is it also more costly in terms of opportunity costs. Add these up over a lifetime of investing and the costs are huge, potentially making the difference between a great retirement & a so-so retirement.

This herd-like behaviour also reaches a crescendo whenever certain markets or parts of market overshoot, attracting huge flows from the investing public. Newspapers are filled with great-return stories tempting a lot of investors to chase after the latest “hot” sector.

Over a career of almost 30 years have I seen this behaviour time after time only when the dumb money starts flowing into a certain sector does one know that it’s time to get out.

Another reason why investors under-perform is that they simply don’t know that their investments are under-performing. This can be the result of ignorance (about how other investments are doing) or that the true state of affairs is actually hidden from them by their investment companies or advisors.

Much what goes for “independent” investment advice today is nothing but biased and uncritical selling by agents or advisors tied to the large investment companies. This is still prevalent in the insurance companies and where advisory companies have their own in-house funds.

SO HOW CAN YOU BECOME A BETTER INVESTOR? Here’s some guidance.

Rule no 1: Control your emotions.

The past three years or so have been a prime example of what is being discussed. We spent a considerable amount of time urging existing investors to avoid seemingly ever-rising resource shares, sticking to value-based sectors offering compelling value. We stuck to our guns and said it quite often: the resources sector is notoriously volatile and while the historical returns have been good, do we prefer the long-term potential of banks and industrial shares at this time.

Furthermore, due to the unpredictable nature of investments do we prefer balanced funds to build long-term portfolios, rather that funds that track the JSE All share, for example.

There is too much focus on the JSE All share index in our view. This index is very volatile and we rather try and find balanced funds that often match the overall returns of the JSE without the same large swings in capital values.

Discipline, in our view, is one of the greatest contributing factors to creating long-term wealth. Read any of the countless books on how to become a truly good investor and they all say the same: a disciplined approach to investing will make the difference between an average return of 8% per annum and the 14% per annum, as shown in the table.

Remember: you cannot control the markets but you can control your emotions!

Rule no 2: Stay the course.

Investing is a parallel for life: it’s not always a smooth ride. In fact, if you think that investing is easy and that your capital will grow in a steady ever upward trending line, then think again.

Certain investment companies will try and conceal this inherent volatility and unpredictability in investment markets by means of what is known as “smooth bonus funds”, but remember what *Warren Buffett once said:* ***“I would rather prefer a bumpy 15% per year than a smooth 10% per year on my investments.”***

Many global studies have shown that private investors are particularly bad at picking the right time to buy and sell. Short-term changes in the market should not be a reason to change your investments, hard as it might be at times when the markets are falling. In fact, falling markets are often a great time to add more money to your long-term investments.

The only time when drastic changes are warranted is when your personal circumstances have changed. Examples would include losing your job, bad health or any other issue that forces you to change your risk profile.

Rule no 3. Define your investment objectives.

Investing your money without clearly formulating your investment objectives is like driving in a foreign country looking for a certain town or city without a roadmap. You could just get lost.

Likewise, you should have a clear understanding at what your ultimate objective is. Are you saving for retirement 10 or 20 years away, are you requiring an income or are you saving for something specific like an overseas holiday or the deposit for a motor car?

This is where the advice and guidance of an investment planner at **Brenthurst Wealth** really comes to the fore. Our team of investment professionals will spend a lot of time with you, first establishing your risk profile, defining your investment objectives and then recommending an appropriate strategy in writing. This is just the start.

Unlike a previous generation of investors who never heard from their investment companies again after they signed some application form, do we regularly meet with clients to evaluate their performance.

We try and apply the 90-day principle: we communicate with our clients at least every 90 days, either telephonically, via post, email or at our very popular quarterly investment seminars.

Our business model is not transaction-based but is one of creating & sustaining lifelong relationships built on trust.

Rule No 4. Understand the process.

Understanding the process is an integral part of investment success in the long run.

At Brenthurst Wealth we spend a considerable amount of time & energy on educating our clients on investment products.

OUR PROCESS INCLUDES:

- ESTABLISHING A RISK PROFILE

  most new investors have no clue as to their investment
- FORMULATING AN INVESTMENT STRATEGY.
- EXPLAINING THE PROCESS.
- IMPLEMENTING THE PLAN.
- MONITORING THE PLAN.
- ADJUSTING THE PLAN OVER TIME.

Rule No 5. Get truly independent investment advice.

Never ask a barber for a haircut. This is an old saying in the investment world, but it has more than a shred of truth contained in it.

How independent are your traditional investment advisors?
How certain are you that the advice you are getting is in YOUR interest and not in someone else's interest.

Recent legislation (the Financial Advisory and Intermediary Act of 2004) has substantially improved a previous incestuous relationship between advisors and the large banks & insurance companies. This has made a huge difference in the quality of advice available to investors.

SECTION 2

THE PSYCHOLOGY OF BAD INVESTMENT DECISIONS:

In recent years a massive new field in the study of behavioural finance has developed in many parts of the world, including South Africa.

Behavioural finance uses psychology-based theories to explain how rational (or seemingly rational) individuals fail to make rational investment decisions.

Evidence is mounting that your personality plays a far greater role in investment performance in the long run than what was generally considered to be the case.

There are a number of theories that explain stock market anomalies and market behaviour. For example:

ANCHORING is when we use historical reference points to "anchor" decisions. Investors tend to use the past and most recent information to relate to future prices, making the mistake of ignoring longer-term or newer information.

For example, a generation of SA investors grew up thinking that by investing in gold and gold shares you will protect yourself against global political and economic turmoil. Yet SA gold shares have been the worst investment over the last 28 years, yet you still find investors believing that "one day gold shares will come to the rescue again", and they keep on trotting out the same arguments that might have been valid many years ago.

REGRET AVERSION explains how we fool ourselves to justify poor past decisions. Investors often avoid new information or concoct illogical arguments to maintain their beliefs and justify poor decisions. The same goes for buying a new motor car, for instance. We refuse to hear or believe any bad news on our decision, because it does not reflect well on our decision-making ability. The same goes for investments.

There is no place for misplaced pride in the investment world. Or as the old saying goes:*"If you have got onto the wrong bus (investment wise), get off and get onto another one that might take you were you wanted to go."*

OVERCONFIDENCE explains why confidence in a little knowledge is very dangerous. Investors often base decisions on a flawed or inadequate intellectual framework and believe they have the ability or expertise to predict the future. This leads to poor investment decisions based on speculative thought.

This is especially true when investment markets are running hard: investors become overconfident, not truly understanding why they are doing well (they just assume it's because they are so smart). A prime example in recent years has been the residential property market. Many investors over-committed themselves, ignored the risks building up and are now paying the price.

HERD BEHAVIOUR must be one of the most dangerous activities in the investment world. Investors often base their investment decisions on what other investors are doing instead of using a rational considered framework for making decisions.

Many investors are so afraid of being "left behind" that they will abandon all rational investment behaviour in order to keep of with the herd…often with disastrous results. The history of the world is littered with examples of such dangerous trends. The herd is more often wrong than right.

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