THE BALANCE BETWEEN BEING AN AVOIDER AND AN ASSERTIVE

By Florbela Yates, Head of Momentum Investment Consulting

Florbela Yates

We believe in the value of financial advice. Financial advisors play a key role as financial coaches to their clients, often helping clients reduce the effect of their own potentially destructive financial decisions made by biases that could affect their ability to achieve their financial goals.

When clients make investment decisions that affect what they should have earned and what they actually earned, they incur a behaviour tax. There are many types of behaviours that can adversely affect an investment, such as leaving money in cash for too long instead of building a diversified portfolio or switching to funds that appear to be offering better returns. Maintaining focus on a set goal can minimise behaviour tax. Our research* shows that in some cases, behaviour tax can cost an investment 1.11% a year, which amounts to about a 17.5% difference in fund value over 20 years.

Through our machine-learning techniques, we have identified client behavioural patterns during market cycles. From the 'avoider's, who don't take enough investment risk, to the "assertives", who are overconfident and take too much risk, we have started using this data to show financial advisors personal insights about their clients' financial personalities and likely investment behaviour.

Another investment bias that can affect a client's financial outcome is if they choose funds based on past investment returns. They use this cognitive shortcut because, with the overwhelming number of funds available, making a strategic choice can be daunting. But the reality is that past returns are not reliable predictors of future returns and offer a false sense of confidence that may ultimately prove disastrous for a client.

A landmark study conducted by Momentum Investments and Oxford Risk, based in the UK, during 2020, clearly showed that people in South Africa with the same investment needs were getting very different advice. This occurs because of the timing of when the advice was given, and some of the biases mentioned above. The best way to ensure consistency for clients with the same investment needs is by constructing an investment solution specifically designed to achieve an investment goal. In that way, these clients will always be treated the same.

Financial advisors are increasingly partnering with discretionary fund managers (DFMs) to construct investment solutions that are more closely aligned to their clients' needs. By appointing a DFM to construct and manage their portfolios, advisors can increase the probability of keeping their clients invested and avoid biases.

At Momentum Investment Consulting, we understand the importance of building robust portfolios designed to deliver real growth over the investment term, while actively using risk management principles to make sure capital isn't completely eroded during severe market sell-offs. Everything we do, from asset allocation and fund selection to mandate design, is done to make sure the portfolios are optimised regardless of the current market cycle. We understand the importance of getting clients to their goals and for them to enjoy the journey towards those goals. Because with us, investing is personal.

More than half of the people in South Africa retire without sufficient savings, and many are still trying to pay off debt in their post-retirement years. The need to invest in a portfolio that suits their personal needs has never been more pronounced than it is right now. The Covid-19 pandemic has increased people's need to protect their investments so that they last for the rest of their lives. In these uncertain times, we remind our clients not to panic, to stick to investment goals agreed with their financial advisor and stop worrying about the returns of their friends' investments.

While it may be true that the average unit trust in South Africa has battled to significantly outperform inflation in the past five years, it's worthwhile reflecting on whether it was designed to do so. We are often quick to complain about poor returns, but have we asked ourselves what we were expecting from the fund that we invested in? Did we choose it to meet our objectives, or because it had a good track record? Do you understand the manager's investment style? What criteria does the investment manager use in selecting the underlying assets they invest in? Are they benchmark cognisant? What percentage is invested offshore? What effect does rand volatility have on an investment? Is the fund actively managed or does it use passive or smart-beta strategies? These factors all affect the way a fund performs.

We understand the importance of getting clients to their goals and for them to enjoy the journey towards those goals.

Understanding what to expect from the fund is a great starting point in determining whether it is suitable for a client. If the fund has a benchmark that isn't aligned to a client's investment goal, it may well be time to consider an alternative. ■

Momentum Investment Consulting (Pty) Ltd is an authorised financial services provider (FSP32726) and part of Momentum Metropolitan Holdings Limited and rated B-BBEE level 1.

*September 2019. The South African investor behaviour tax and helping investors count what counts. Momentum Investments