There ain't no such thing as a free lunch, except...

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We all have our vices. Investors battle with theirs in the form of portfolio concentration, appealing in several ways, but it could ultimately be bad for their (financial) health. While concentration has been rewarded for much of the past decade, we believe true diversification is much more important now.

There is a natural tendency to concentrate portfolios into yesterday's winners, either through a passive approach that chases winners by design, or as the path of least resistance. But while the so-called 'FANGS' (comprising Amazon, Netflix and the like) may be great businesses, with over 9 000 international stocks for South African investors to choose from, can one really justify concentrating into less than 1% of those, as many do?

The pandemic should have served as a potent reminder of the need for diversification – a classic black swan event that punishes those who were overconfident and had all their eggs in one basket. However, that lesson has been missed by many as the eventual beneficiaries were the previous winners, namely expensive growth stocks, which many were itching to buy more of based on past performance. Diversifying assets were left for dust on a relative basis. But imagine a parallel universe where Covid-19 was an unstoppable digital virus.

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This year we are entering a new, more difficult phase of this economic cycle – one which will bring considerably more volatility – and could see a sharp rotation in market leadership. While the US market and high growth stocks have outperformed for much of the past decade, today's very different environment of high inflation and rising interest rates will undoubtedly lead other sections of markets to pick up the baton.

We believe under-owned and under-valued markets, like the UK and Japan, offer much better return prospects than the US market at the broad index level. Beneath the surface, stocks on lower valuations, often in more cyclical industries or with asset-heavy business models, are set to outperform – potentially on a sustained basis for the first time in a decade. Strategies with limited exposure in these areas remain vulnerable to the type of violent rotations we saw at the start of this year.

'There ain't no such thing as a free lunch,' goes the saying. The exception in investments is diversification. Some of the greatest value that investment managers can add is through countering the behavioural biases that so often undermine investor returns. Today's environment calls for exposure to a wide range of geographies, sectors, and the confidence to position very differently from market indices. The opportunity cost of not doing so may prove painful in time.

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With us, investing is personal, and outcome-based investing aligns well with what clients want to achieve when they invest offshore, namely an absolute real return in hard currency. An absolute indication of expected outcomes provides a more tangible goal for clients and helps them stick with their investment when times get tough.

At Momentum Global Investment Management, our multi-asset, multi-style and multi-manager approach builds in additional diversification levers that help smooth the investment journey we create for our clients.