Diversification – friend or foe?

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When it comes to investments, there is a mountain of complexity, from the choices of available funds and products to the often mystical language that is used.

One thing that we do know is that diversification is not included in that view. Diversification is a way to minimise risk by spreading the investment throughout the investment universe, which includes investing in different asset classes, geographies or industries.

Given the current environment of more volatile and uncertain markets, which involves a heightened risk of losing money (but at the same time opportunities to create wealth), diversification has become the de facto consideration. I suppose it always has been.

If we look at where investors have invested in the last two years, it really has been in multi-asset-class unit trusts. This does not come as a surprise because, as investment managers, we have been beating the drum around diversification since our early existence. The number of industry assets invested in multi-asset-class funds hovers around the 50% mark. This shows that investors believe in at least one form of diversification: asset class diversification.

On closer inspection of the flows (not assets), we see a strange trend and that is how investors behave during heightened risk: They flee to safe-haven assets such as cash. And they get stuck in cash without participating in the recovery. This is often referred to as the switch itch. Research showed that investors switched 71% to interest-bearing funds in 2020 and 2021*.

By using industry data, it is evident that investors often do not maximise the benefits of diversification because of chasing performance or getting stuck in cash. Cash is a single asset class and although it does have an element of market protection, it often delivers lower returns in bull markets.

At Momentum Investments, we adopt diversification tactics so that financial advisers and their clients do not need to switch. Whether you put your own portfolio together or whether you choose our off-the-shelf best investment view capabilities, both our single asset-class funds and multi-asset-class funds are positioned for this and make your investment choice personal.

It is enhanced through our outcome-based investing philosophy that is best represented in our multi-asset unit trust range through a few diversification lenses:

- Asset classes
- Investment styles
- Managers we use because we use Fund of Funds.

We aim to maximise returns in all three factors mentioned above.

An example of this is through investment style selection: Value investing (investing in companies that are undervalued) is a well-marketed strategy in South Africa. However, investing solely in value may not always result in a comfortable journey for clients. When incorporating a growth-orientated style (often in disruptive companies that are rapidly growing) brings in a layer of diversification, protecting investors and enhancing the return through market cycles.

Diversification demystifies the complex world of investing. It enables a risk-management approach while ensuring that suitable returns are delivered, despite the noise that investors face.

**Source: Asisa.org, 31 December 2021*
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