The risk of not paying attention to risk

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Investors are exposed to different risks when investing. These risks can include interest rate risk, credit risk, inflation risk, volatility risk and political risk.

Our investment philosophy – outcome-based investing – is that we target a specific return over a chosen period and we define risk as the likelihood that the fund won't deliver the return it's targeting. It may sound like semantics. However, it means risk doesn't have to be reduced to three simple definitions of 'low', 'medium' and 'high' any longer, but can be described in sync with your client's goals: Will they or won't they achieve their investment goal and, if they miss it, by how much will it be?

Our outcome-based investing approach mitigates against investment risks, and we construct portfolios that are truly diversified across many sources of risk and return. The primary focus of this approach is to ensure funds track towards their outcomes with a strong focus on risk management. This is, however, only a part of the solution. An investment philosophy needs to consider how clients behave when there are risk catalysts and our applied behavioural finance unit allows us to understand these triggers.

It has been proven that it is difficult for clients to remain invested during uncertain times. Momentum Investments did a detailed analysis of investor behaviour preceding and during the Covid-19 pandemic of 2020. Results show that as market crashes go, the investor behavioural response was all too familiar. The period of panic after the effects of Covid-19 became a reality would see South African investors lose about R100 million between April and December 2020, due to fear-based investment switches. As panic set in, the number of switches in March 2020, at the time of the crash, spiked to nearly 300% compared to the number of switches in January 2020. We also clearly see a 'risk off' strategy for March and April as investors moved to 'safety', or at least they think so.

ON THE SIDELINES WAITING

The latent effects of this value destruction are rooted in investors rushing for safety and getting stuck in safe assets where they remain for a large portion of the inevitable market recovery. They're in the wrong place at the right time; on the sidelines watching. We believe in the value of financial advice, and this is where the financial adviser can play a crucial part in helping clients to stay invested. Advisers can help clients change their thinking so they realise that staying the course is as important as choosing the right fund and that if your personal circumstances haven't changed, you shouldn't be changing your investments.

To mitigate the risk of switching, it is crucial for clients to invest in well-diversified funds that invests in various asset classes both locally and offshore. A combination of asset classes will reduce a fund's sensitivity to market swings and make the journey to the client's outcome smoother, and help them to stay on track to achieve their personal investment goals. Diversification is the most important factor for reaching long-term financial goals while minimising risk.

THE TOOLS ASSOCIATED WITH RISK

It is important for clients and financial advisers to understand the risks associated with the type of funds or solutions they are considering. There are a number of formulas which are used to measure risk and clients should not be discouraged by the investment jargon used in fund fact sheets. All risks aren't made equal. Importantly, risk is only one aspect in the overall consideration of investments but a critical one. To quote Warren Buffet: "Never test the depth of a river with both of your feet". This quote highlights the importance of diversification as one of the biggest benefits to managing risk.

At Momentum Investments this is where our philosophy meets our portfolio construction process across our range of single and multi-asset funds, both locally and globally. We take the noise, jargon and fear of risk out of the financial adviser's lives and make it our business to manage it. With us, it's that personal. **When it comes to investments, there is a risk of not paying attention to risk. But the bigger risk is trying to manage it yourself.**