

LESSONS FROM 30 YEARS IN FINANCE

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TAKING ON THE CHALLENGE TO RETIRE FINANCIALLY SECURE: WHY START EARLY AND, IF NOT, HOW TO MAKE UP THE SHORTFALL.

LESSON: ACTIVE ASSET ALLOCATION ADDS VALUE

While thirty years may be considered short term compared with the time frames we look at in our Long-Term Perspectives publication, my career has been full of lessons. These include, but are not limited to:

- The emerging market crash of 1998
- The dot-com bubble
- The Global Financial Crisis (GFC) of 2008
- The Covid-19 pandemic shutdown in March 2020.

These events were significant because they offered considerable opportunities for creating asset-allocation alpha. For instance, during the emerging market crash of 1998, South Africa kept hiking short rates up to 25.5%. This dragged 10-year bond yields up to 20%, creating a superb buying opportunity in the South African bond bull market (see page 43 for more on the bond market's reaction to economic and political events).

LESSON: FOCUS ON THE LONG TERM AND AVOID THE NOISE

The GFC was my career-defining event. I had just taken over the leadership of Old Mutual Investment Group's Multi-Asset Investment Team (previously MacroSolutions). This division was responsible for the asset allocation of all Old Mutual's multi-asset class funds, including the country's largest life assurance book. While we had reduced risk into the crash, the contagion into all assets meant that there was no safe-haven asset – even cash funds were breaking the buck. However, the very tools outlined in this publication gave us a long-term perspective and the courage to step into the market, ultimately buying shares worth billions of rands.

The Covid-19 crash was more of a market event than a major market inflection. We were underprepared for it, holding too much risk. However, we used it as a unique opportunity to add equity at great prices and flew out of the crash.

The key lesson is to focus on the big picture and avoid getting sucked into the short-term noise.



LESSON: ACCESS THE FULL TOOLBOX, AND FEES MATTER

One of the competitive advantages of a multi-asset or solutions manager is the ability to buy alternative assets. Over my thirty years, our ability to access both usual and unusual, less analysed listed assets has seen us achieve great success, particularly through investing in convertible bonds, preference shares and property. Where possible, we also invested in unlisted assets, which have delivered solid returns for our clients – though they require a lot of patience.

Early in my fund management career, we invested in hedge funds, but they did not offer adequate portfolio protection in the GFC. The main drawback of hedge funds is the high fees, which is why we have not used them since. A recent global study by LCH Investments showed that since 1969, 50% of hedge fund returns have been taken as fees. This means that clients take on the full risk but only receive half the returns. Fees matter! This is why we removed performance fees from all our solutions.

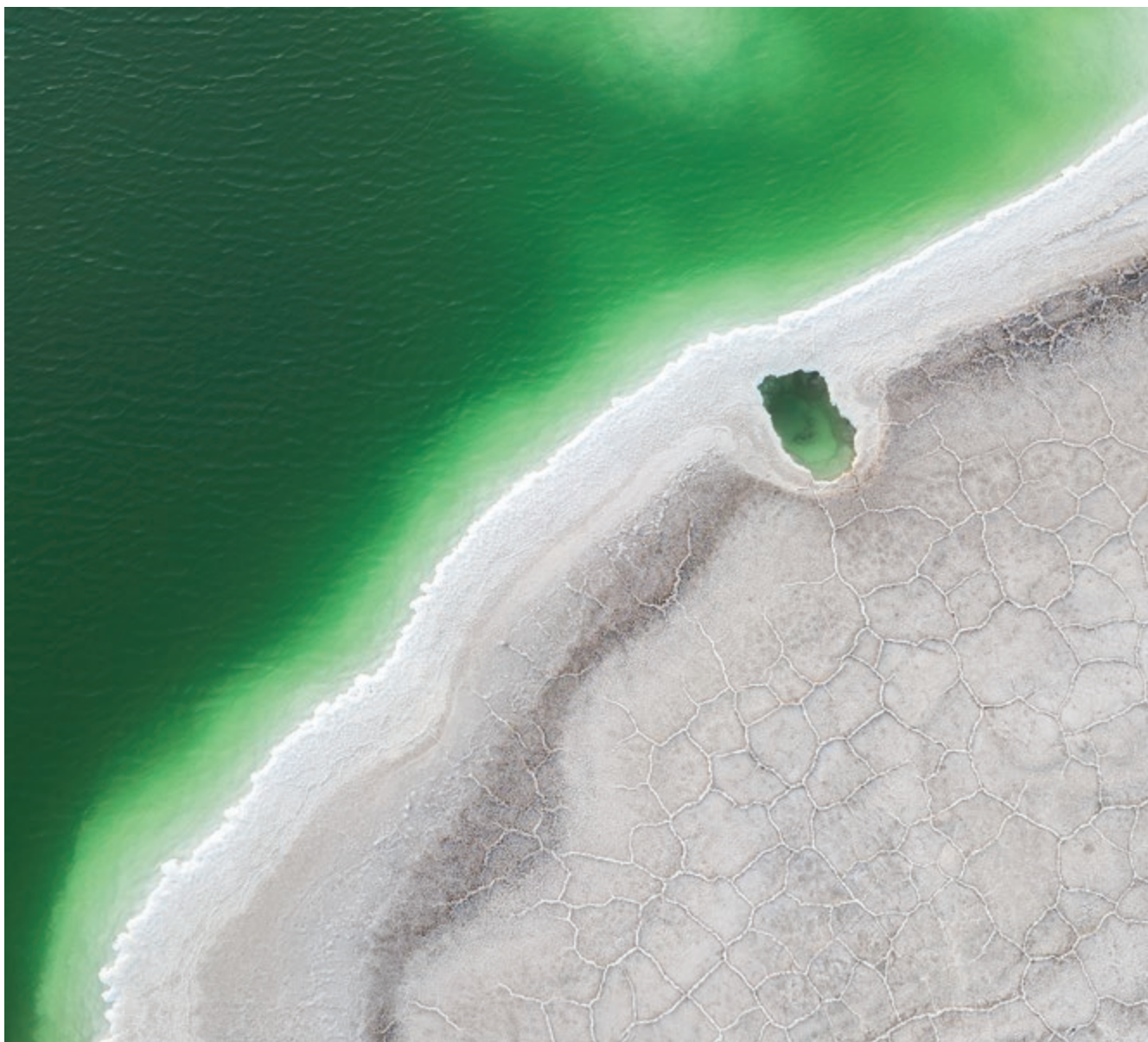
LESSON: INVESTING CAN HAVE A REAL IMPACT

As active managers, we have the ability to participate in corporate finance transactions. However, with the Johannesburg Stock Exchange listings shrinking over

time, unfortunately opportunities are limited. Despite this, we have supported several companies that needed capital.

One of my career highlights was underwriting 25% of Omnia's R2 billion rights issue in 2019, after the company got into balance sheet trouble over the financing of its new nitrophosphate plant. Our support was great for South Africa, Omnia and our clients, who bought shares at R20 – shares that traded at R80 less than three years later. It is within the financial markets' purpose to provide capital for growth. And we were pleased that our commitment as a "certain friend in uncertain times" had a real impact on our economy.

“THE LESSON HERE IS THAT PRESERVING CAPITAL REQUIRES A MORE HOLISTIC APPROACH.”



LESSON: THERE IS A DISPROPORTIONATE IMPACT FROM COMPOUNDING LONG-TERM WINNERS

One of the biggest lessons I've learned is the disproportionate effect a handful of big long-term winners and losers have on performance. This lesson is well backed up by the academic literature, particularly the reports by Hendrick Bessimbinder. His findings show that just over 4% of firms have accounted for all the wealth creation in the US stock market since 1926.

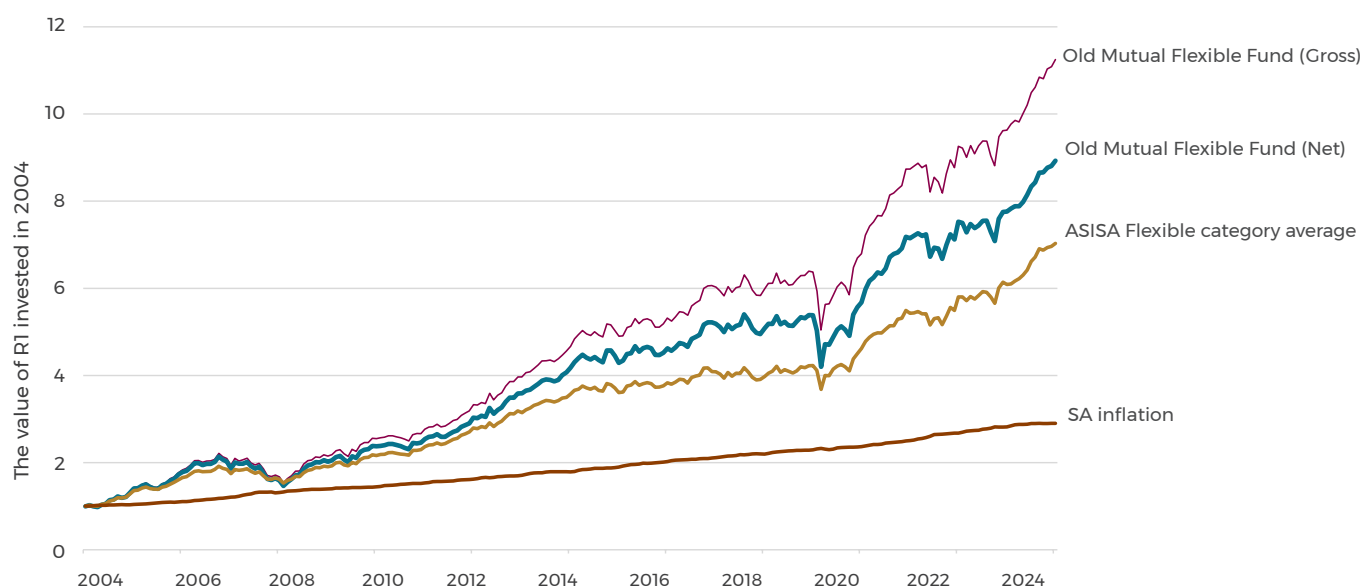
In South Africa, the dominant share has been Naspers, which has grown at 25% a year over the past 20 years. This is an extraordinary story of a single small investment riding the wave of the biggest industrialisation the world has ever seen. However, the compounding effect of good businesses and good management is not a fluke and is an incredibly valuable force that leads to extreme returns. For instance, over the past 20 years, an investment in

Capitec would have multiplied your money 343 times, or 31 times better than the market. I was late to this lesson and completely missed Clicks for two decades.

LESSON: DEFENCE ADDS VALUE

On the flip side, investing is also about avoiding the losers. In the Bessembinder study, 35% of all US companies have been delisted since 1926, with a staggering 92% capital loss. In South Africa, the two most notable bankruptcies were African Bank and Steinhoff. While African Bank wasn't that big on the equity side, its debt exposure posed significant risk for multi-asset class funds. We largely dodged that bullet because our analysis blended different perspectives from our equity, credit and unlisted teams – a key advantage of our integrated approach. Steinhoff was another test where we protected client capital. Our philosophy is not solely focused on valuation and our emphasis on governance risk flagged concerns early and prompted us to sell, even though Steinhoff looked

CHART 2: OLD MUTUAL FLEXIBLE FUND'S 20-YEAR TRACK RECORD



Sources: Factset; Old Mutual Investment Group

cheap at the time. The lesson here is that preserving capital requires a more holistic approach. It demands a broader perspective and a deep understanding of risk beyond valuations.

LESSON: CLIENT ALIGNMENT AND ADVICE ALLOWS COMPOUNDING

Fund management is a career that never leaves you completely satisfied. When you make a good investment, you should have done more; and when you make a mistake, you shouldn't have invested anything. My way of getting through the highs and lows of fund management is to always focus on the client's objective. I enjoy building solutions and, in particular, managing more aggressive or dynamic funds, as they allow for greater freedom to allocate capital to where the opportunities lie.

I invested all my own money in these same funds, which gave me the confidence to hold on, as I believed I was doing the right thing for both myself AND my clients. Over the past 20 years, the Old Mutual Flexible Fund has delivered a real return of 7% gross and 5.8% net of fees. Once you add in the power of compounding, these are very satisfactory outcomes – R1 million invested when I joined in 2005 would now be worth R8.9 million.

While I had the privilege of knowing exactly how the solution was built and believing in the investment

process, it is more difficult for a client to hold the faith and remain invested through the market noise and the turmoil.

And this leads to my final lesson: the fee paid to financial planners and advisers, who help keep their clients invested and benefiting from compounding, is well worth it.

“OVER THE PAST 20 YEARS, THE OLD MUTUAL FLEXIBLE FUND HAS DELIVERED A REAL RETURN OF 7% GROSS AND 5.8% NET OF FEES.”