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Don't let panic cloud your reason

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Investors' worst fears of a double-dip recession seemed to come true this week.



A man reads a newspaper below an electronic board displaying share prices at the Karachi Stock Exchange this week

" Having an investment professional making these calls for you is most important "

If more volatility is inevitable, what lessons did we learn from 2008 and what should we do now? The answer depends on how much time you have.

DO NOTHING

Kaplan Equity Analysts MD Ernest Kaplan said probably the best course of action for investors with time on their side is to do nothing. "I'd caution against making panic changes to asset allocation in the face of world events. The danger is that you won't know when to get back in, and it's been proven that timing the market just doesn't work. The problems being experienced by the US and Europe are no reason to get out of the market because it's just not clear what will happen from here."

Kaplan said any quantitative easing in the US might lead world markets to respond positively thanks to more liquidity. "I would stick with good stocks right now because I'm not convinced of a drastic call either way. It all depends on your investment horizon, the make-up of your portfolio and the percentage of money you have offshore. For the average South African investor with the majority of exposure to local stocks and a long-term view, switching to an income outlook to try to beat inflation might mean you miss the boat - we might have seen the major correction already, which means it could be a good time to buy even more shares. Investors have made money since 2008 and I think these events will be irrelevant for long-term investors."

Instead of trying to time the market, it makes more sense to keep making consistent contributions to an existing investment, said Rowan Burger, head of investment strategy at Liberty Retail. "The benefit is that assets are bought on your behalf through the duration of the economic cycle. Your next contribution will buy more assets than your previous ones did, as a result of the market correction. This is referred to as rand cost averaging and takes the risk out of trying to time the market."

Burger said Liberty has recently moved underweight on equities with an eye on greater volatility and muted returns. "In these uncertain times, we believe clients are best served in a balanced fund holding a diversified range of assets with an asset manager carefully protecting your assets full time. Stick to your original investment plan and if you are concerned that you may lose capital, now may be an opportune time to consider purchasing an investment guarantee," said Burger.

"It is very easy to panic and let emotion take control of your investment decisions. Having an investment professional making these calls for you is most important. Cancelling your long-term savings plans just after large falls in the market is a costly mistake. The market tends to overreact to bad news and then there is a temporary recovery shortly thereafter. Reasons for making changes should be as a consequence of changes to your personal circumstances and not knee-jerk reactions to the market. Allow your investment manager the freedom to make the most of these short-term opportunities and reap rewards over the long term," Burger said.

IF YOU ARE NEAR OR AT RETIREMENT

For investors who are close to retirement, current world events might be more significant. Marriott Asset Management investment professional Duggan Matthews said Marriott's dividend growth fund is an example of a high-performance but low-volatility fund that has been generating high returns. "This contradicts one of the fundamental principles of modern portfolio theory - the concept that more risk equates to more reward. The primary benefit and focus of the fund is to provide investors with a reliable and growing tax-free dividend income stream."

This type of income-focused investing involves concentrating on businesses with reliable and growing dividend track records to ensure an investment made in that company today will benefit from those advantages into the future. Matthews said the fund looked for companies likely to retain and grow their customer base, protect margins and increase their dividend payments regardless of the economic circumstances. "Over the last decade the fund has grown its income by inflation plus 7% on average per annum. Capital growth has largely mirrored this income growth," Matthews said.

DIVIDENDS

If you're on the hunt for dividends in your portfolio as a way to beat inflation through the next dip, Matthews said the telecommunications sector is offering good value. "For example, the forward yield of Altech and Vodacom are both in the region of 6.5% with reliable growth prospects. Dividends are tax-free in the hands of the investor, making these income streams highly attractive in comparison with cash and bond interest rates. Typically, companies operating in the banking, pharmaceutical, food and telecommunication industries produce the most reliable dividends."

Gail Daniel, portfolio manager of Investec Managed Fund, said for anyone nervously sitting on equity investments, the flight to capital preservation is understandable, but you should trust your asset manager. "In a multi-asset fund we have the flexibility to actively allocate between the different asset classes and we continuously manage the division between capital growth and capital preservation.

Over the last few months we have taken a more defensive stance. The problem with the 'safety' of cash is that while capital is preserved in nominal terms, low interest rates and rising inflation translate into negative real returns for investors."

Instead, Daniel said, her fund has increased its allocation to defensive assets that typically provide returns not connected to equities during times of heightened uncertainty. "Gold is one of these asset classes. During times of heightened equity volatility, the price of gold in rands tends to appreciate in value. This is again the case at present and is providing much-needed protection of capital in both real and nominal terms."

Daniel agreed with the view that in a low-growth environment, returns generated from dividends become increasingly important. "When selecting shares, emphasis is not just placed on the companies that offer the highest dividend yields, but we also place emphasis on companies which are in the best position to maintain and grow future dividend payments, even in difficult economic conditions. We currently prefer shares such as Vodacom, British American Tobacco, Santam and retailers such as Mr Price and Woolworths. Dividend yields on these shares are in line with or even higher than money market yields and are expected to grow dividends in real terms (above inflation) over the next 12 months," she said.

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