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CREATING FINANCIAL FREEDOM

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Steer through the turmoil

Investors who take a long-term view, remaining calm during the market's ups and downs, will reap the rewards

One of the foregone conclusions of life is that almost all decisions and choices you make will come with a level of risk or potential for losses.

Your choice to drive the car to work comes with your acceptance of the risk of an accident.

If you are elderly and frail, your choice to get out of bed and go for a walk for the health benefits comes with the risk of falling.

If you are an investor, you are accepting that share prices may go negative over the short term, and make you feel poorer, against your well-rationalised basis for investing for wealth generation over the long term.

For some of us, the fear of loss can be too intense and debilitating. In fact, loss aversion can be one of the key impediments to making logical and rational investment decisions that have a high probability of delivering prosperity over the long term.

The level of loss aversion obviously varies in each of us, as it is shaped by our upbringing, our influences, our socio-economic background, our knowledge and education. Let's call this the type of loss aversion resulting from idiosyncratic factors (I just made up the term, but you know what I mean) that are more personal to an individual investor.

However, there are also more transient factors for loss aversion, such as pandemics, job losses, wars, climate change, accidents and major social-political events, that can make people risk averse for a period of time. These transient influences can be shorter term, such as Covid-19, which in due course will pass – and we all know that the fear of loss of life from the pandemic has gone from being very high and scary two years ago to manageable now.

Equally, there are other transient factors that can go on for months and years but eventually pass, though I think climate change mitigation will take some years. Nevertheless, transient influences often play out at societal level and we (investors) all experience them together and we are likely to feel the level of fear and anxiety as a group.

Moreover, investors and fund managers are living and breathing individuals from among us. They are currently experiencing and navigating the challenges of highly uncertain times, such as managing health setbacks due to Covid-19, caring for ageing parents (if not aged themselves), constantly worried about outliving their retirement nest eggs, gradually developing chronic medical conditions as they age (the median age in Australia is close to 40), career uncertainties, the rising cost of living, high debts and global political tension and what it could mean for our way of life.

So, it is not at all surprising that mental health and anxiety in the community have been rising in recent years. In fact, the latest figures from the Bureau of Statistics show that almost a quarter of our population (21.4%) have had some mental disorder or anxiety-related issue in the past 12 months. That, in my view, is highly under-reported, as I would hazard a guess that most people experiencing anxiety or fear don't seek help.

With that background of anxiousness in the community, it is not an illogical inference that loss aversion will be quite high among investors right now.

That is not to say that investors don't want to generate great returns; they just have diminishing emotional reserves to deal with the fear and pain of losses along the way – unfortunately, a necessary evil of investing.

To give you a sense for how short-term-focused investors have become, the average stock-holding period in the US has consistently declined over the past 70 years from eight years in 1950 to a mere five months now!

The holding period for "the oracle of Omaha" and the godfather of long-term investing, Warren Buffett, is 20 years.

3 FUNDS TO WATCH

1 Pendal Focus Australian Share Fund

This actively managed portfolio of Australian shares exhibits high-conviction ideas (15-30 stocks) to deliver higher alpha. It aims to outperform the S&P/ASX 300 Accumulation Index over five years or more. In our view, the team can undertake in-depth research across the market capitalisation spectrum to uncover an informational advantage relative to other market participants.

2 Fidelity Australian Equities Fund

Invests in a diversified selection of around 30 to 50 Australian companies, using a bottom-up selection approach that focuses on undiscovered earnings potential, value and growth and is designed to be a core holding. The fund aims to achieve returns in excess of the S&P/ASX 200 Accumulation Index over the suggested minimum investment time period of five to seven years.

3 eInvest Better Future Fund

We believe sustainable investing in small to mid-cap companies is an attractive proposition and worth consideration in client portfolios. There is an increasing weight of investment funds chasing quality companies with strong ESG credentials. Consequently, there is a flywheel effect (or virtuous cycle) in the ESG space that is spinning faster and faster. In our view, this fund provides an attractive, active exposure to this space. The investment process takes an "ESG-first" active management approach.

In my humble view, investors need to at least hold stocks for five years or more (average holding period in their portfolio) to call themselves long-term investors and reap the benefits of the 8%-12% annual return the markets should deliver through various multi-year cycles.

As a rule of thumb, you can quickly work out how long-term focused a fund manager is by asking for its portfolio turnover rate. A portfolio with a five- to 10-year average holding period would turn over somewhere between 10% and 25% annually.

Short-termism raises the risk of locking in the losses by selling when shares decline

By contrast, in the case of the average five-month holding period, such an investor or fund manager has an annual turnover rate of 300%, so there's lots of buying and selling and they are very short-term focused with a high risk of losing money.

Short-termism raises the risk of locking in the losses by selling when shares decline, and also can mean missing out on the gains in market rallies by being too risk averse and sitting on too much cash.

A good way to manage your fear of investing is by having a professional and experienced adviser by your side through thick and thin. Work out your risk profile with your adviser and develop a long-term investment plan and stick to it.

Max Riaz is an investment manager and director at Banyantree Investment Group, with responsibilities across equity and multi-asset strategies. See banyantreeinvestmentgroup.com.