FUNDS ON FRIDAY
by Glacier Research

glacier
by Sanlam

14 April 2023
Volume 1177

Not simply passive – only dead fish go with the flow

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Many well-known and highly regarded investors such as Warren Buffett and Jack Bogle encourage a buy-and-hold approach as being ideal for individuals seeking healthy long-term returns.

Very often this is easier said than done – the temptation to fiddle, fix or hustle is all too often irresistible. This is commonly due to one of the Great Destroyers of Wealth: **emotion**. Typically, mixing emotion with investment decisions is a dangerous cocktail, one that is likely to hinder the investment process, making it difficult to think rationally while maintaining an objective perspective.

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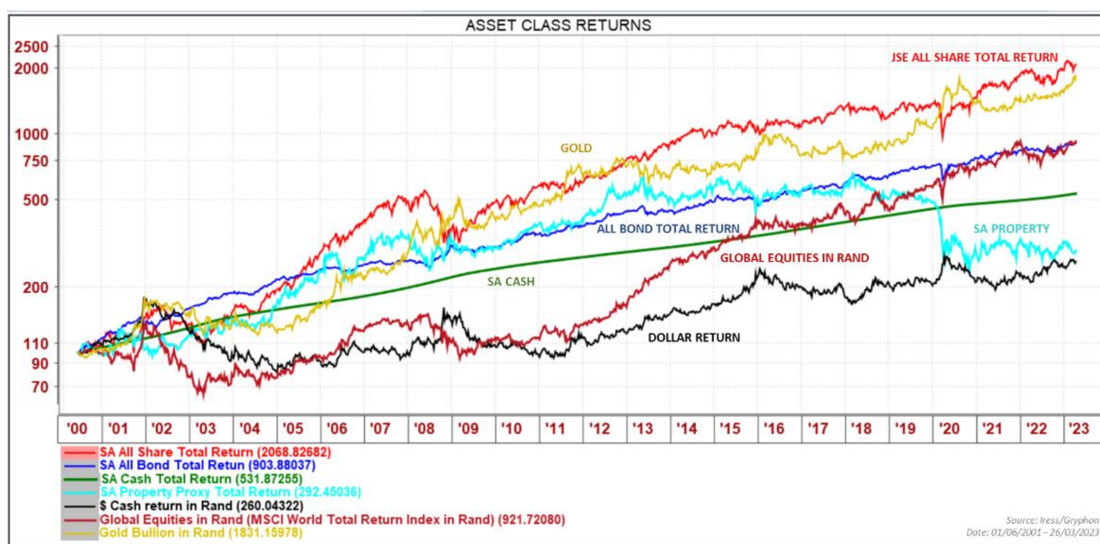
Time and again, after suffering a severe decline in stocks held, remorse kicks in leading to the investor having a panic reaction and choosing to sell – only to watch the stock rebound shortly thereafter. Alternatively, greed gets the better of them when talk on the street is all about spectacular returns, and they decide to buy more of the stock at the worst possible time. This is typically the irrational behaviour that results in the destruction of wealth.

In a recent Gryphon article, *Zen Investor, Beginner Investor*, we discussed how conditioned we are to believing that 'doing something', anything, is preferable to 'doing nothing'. And so it is that we've come to expect that any solution, any fix, will be the consequence of frenetic activity – and very often we expect that the louder/brighter/busier the activity, the more effective the solution will be.

> *The concept of "non-doing" refers to a state of being in which one is free from the distractions and attachments of the world and can live in the present moment with clarity and awareness. It is a state of being that is often referred to as 'effortless action'. It is a way of being in which one acts from a place of inner stillness and wisdom, rather than from a place of tension, anxiety, or desire.*
>
> Zen Mind Beginner Mind

Equities is the asset class expected to offer the greatest excitement and opportunity, certainly the most likely to deliver inflation-beating returns. As illustrated in the graph below, the returns offered by equities, while highly volatile over the short term, are extremely hard to beat over the longer term.



We have all heard the commonly quoted phrase, “Time in the market is better than timing the market”; a phrase that is very often used to dissuade investors from selling during a market slump.

Our view is that time in the market is best served via passive exposure to the broadest market index available to ensure one captures the benefits of a stock market rise. Extensive research has proven that an actively managed, subjective selection of stocks is most likely to underperform the market, whereas a passively managed index/tracker fund will simply deliver market returns.

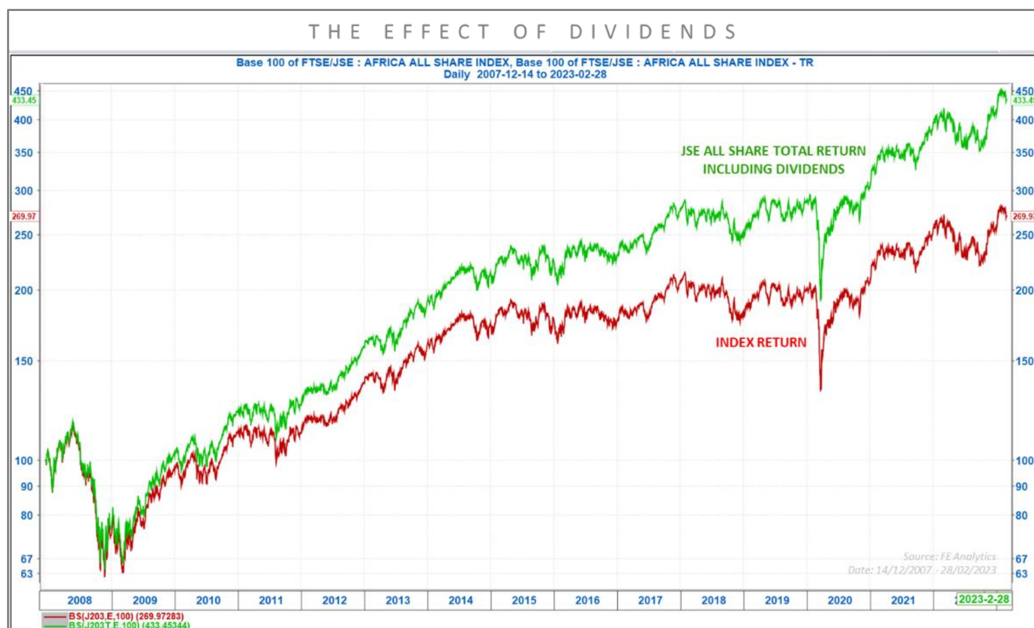
"Over the years, I've often been asked for investment advice, and in the process of answering I've learned a good deal about human behavior.

My regular recommendation has been a low-cost S&P 500 index fund."

Warren Buffett

[There is of course the alternative of exiting equities during times of volatility and protecting capital using other available asset classes – that’s the wonderous phenomenon known as asset allocation but it deserves its own story…]

A simple, cost-effective access is index funds, sometimes called tracker or passive funds. One of the significant benefits of this type of fund is that dividends and interest earned are reinvested which compound the returns on your investment as seen in the graph below – even if share prices may appear to dawdle for extended periods of time (red line), dividends significantly compound the rate of return (green line).



As an equity investor, hustling is an option that can appear very hip, fab and Wall Street. Hustling typically means that an investor works hard to identify and seize immediate opportunities. This may involve networking, researching potential investments, and closely monitoring market trends to stay ahead of the curve. The risks of hustling include:

- Making hasty investment decisions,
- Over-extending yourself,
- Burnout – hustling can be exhausting,
- Lack of diversification,
- Missing out on long-term opportunities.

In simple terms, resist the temptation to hustle – *rather think long-term*. Hustling traps you into the pressure of succeeding for now. Investing with purpose shifts your gaze to the possibilities of the future.

So, does that mean that investing in equities has to be about constantly measuring risk, regular due diligence and analysts' reports?

No.

Benjamin Graham's book, *The Intelligent Investor*, prefaces with this: *to invest successfully over a lifetime does not require a stratospheric IQ, unusual insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework. [This book] precisely and clearly prescribes the proper framework. You must supply the emotional discipline.*

That's the hard part – resisting the desire to fiddle, fix or change.

He goes on to say, *the art of investment has one characteristic that is not generally appreciated. A creditable, if unspectacular, result can be achieved by the lay investor* ***with a minimum of effort and capability****…if you merely try to bring* ***just a little*** *extra knowledge and cleverness to bear upon your investment program, instead of realising a little better than normal results, you may well find that you have done worse.*

He is saying keep it simple…the simpler, the better.

What could be simpler than selecting an index tracker?

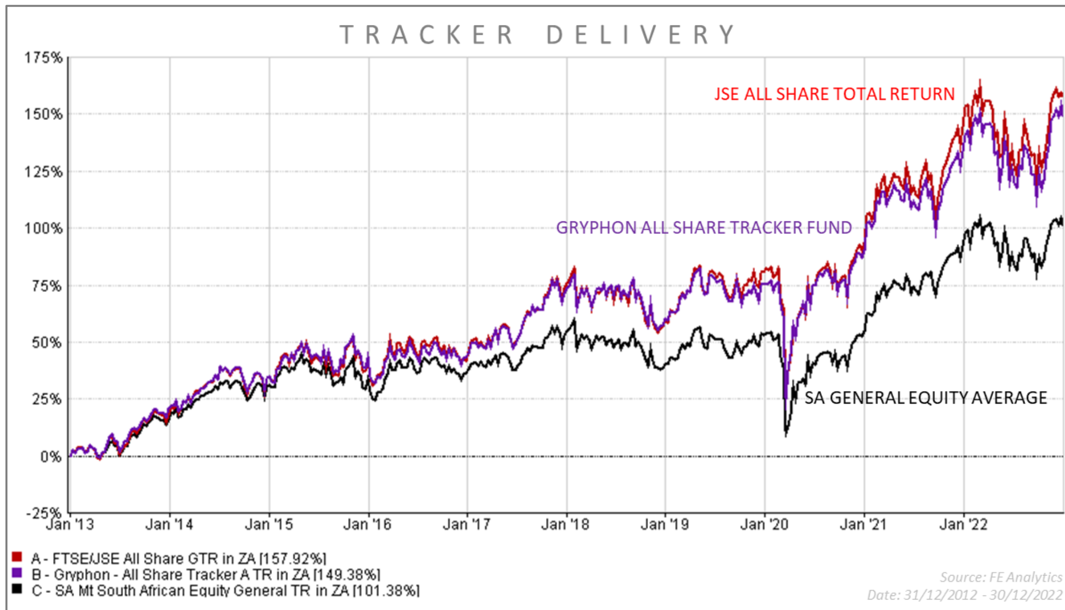
While there is very often a reluctance by believers in active management to make space for indexation/passive investing as an option, one fact is beyond dispute: much of the appeal of index trackers is that they take the emotion (read 'irrational thinking') out of the equation. With this in mind, what more dispassionate way to compile an objective perspective than asking a bot.

We asked ChatGPT3 to prepare a table comparing the active investing with passive investing. Here is the objective and detached information it offered:

Criteria	***Active Investing***	***Passive Investing***
Objective	*To outperform the market by selecting individual stocks or funds*	*To match the performance of a specific market index or benchmark*
Investment Strategy	*Actively buying and selling stocks or funds based on research*	*Buying and holding a diversified portfolio of stocks or funds*
Research required	*Requires significant research and analysis*	*Requires little to no research*
Management Fees	*Typically, fees are higher due to research and trading costs*	*Typically, fees are lower due to passive management and fewer trades*
Risk	*Potentially higher risk due to concentrated holdings*	*Lower risk due to diversified holdings across the entire market*
Performance	*Success is highly dependent on the skill of the investor or fund manager*	*Typically matches the performance of the market or benchmark*
Returns	*Has the potential to outperform the market, but also the risk of underperforming*	*Typically generates returns that track the performance of the market*
Market Efficiency	*Success depends on the ability to exploit inefficiencies in the market*	*Assumes the market is efficient and cannot be outperformed consistently*
Behavioural Biases	*Investors may be subject to emotional biases and make impulsive decisions*	*Investors are less likely to make impulsive decisions and tend to stick to a long-term strategy*

Benjamin Graham's book distinguishes between two types of investors: the "defensive" and the "enterprising". He goes on to say that *the defensive (or passive) investor will place his chief emphasis on the avoidance of serious mistakes or losses. His second aim will be freedom from effort, annoyance, and the need for making frequent decisions. The determining trait of the enterprising (or active/aggressive) investor is his willingness to devote time and care to the selection of securities that are both sound and more attractive than the average. Over many decades an enterprising investor could expect a worthwhile reward for his extra skill and effort, in the form of a better average return than that realised by the passive investor. We have some doubt whether a really substantial extra recompense is promised to the active investor under today's conditions.*

According to S&P Dow Jones Indices' data as at 31/12/2022, 70% of active South African funds underperformed the market over a 10-year period. As can be seen in the graph below, a broad index fund with low fees and consistent performance delivers impressive returns over time.



Investors' prevailing obsession with, and addiction to, frenetic activity and fascinating fables are not best applied to an investment strategy. For us, as a rules-based manager, it is fortunate that we have sparkling personalities and scintillating wit because our approach to investing is unashamedly dull.

Temperament is the iron wire on which the beads are strung.

Ralph Waldo Emerson

Glacier Research would like to thank Casparus Treurnicht and Megan Fraser for their contribution to this week's *Funds on Friday*

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Gryphon Asset Management

Cassie has been in the industry since January 2007 and joined Gryphon in 2011, bringing a strong quantitative background which made him a natural fit for maintaining and developing Gryphon's proprietary valuation models and conducting equity research. He is an integral member of the Gryphon team, fulfilling a number of roles but primarily responsible for managing the Gryphon ALSI Tracker Fund. Cassie is considered a campsite connoisseur and applies the same passion and analytic skills to the campsite fire as he does to his funds.

Megan Fraser

Head of Business Development & Marketing

Gryphon Asset Management

Megan has been involved in establishing business development networks in financial services for nearly 40 years. Having worked for Norwich, Investec IMS, Coronation, STANLIB, Fraters, Sanlam Investments, and Aylett & Co, she has a acquired a breadth of experience as well as valuable insights in this time. Her current role with Gryphon provides the opportunity to create awareness and appreciation for the unique, innovative investment approach delivered by this well-established, rules-based investment house. Beyond the office, her passions include reading, travel, holistic health, and trying to get the whole world to embrace meditation.