glacier by Sanlam

21 April 2023
Volume 1178

What we learned from the octopus teacher

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In our previous *Funds on Friday* article, ***Not simply passive (or only dead fish go with the flow)*****,** we used ChatGPT3 to objectively compare active and passive investing. In this article, we pursue this line of thinking, including why it is so challenging to incorporate new information or ideas into our current practices.

Craig Foster is a documentary filmmaker, naturalist, and founder of the Sea Change Project. He is probably best-known for the 2020 film ***My Octopus Teacher,*** for which he won an Academy Award in 2021. Recently I had a discussion with my cousin who had had the privilege of experiencing a snorkelling session with Craig. They dived at Craig's favourite spot, the kelp forests in a remote location in False Bay near Cape Town. Bear in mind that Craig chooses to dive without a wetsuit or SCUBA equipment – just fins, a mask, and a weight belt – and he expected my cousin to do the same! With an average water temperature of about 15°, it's not really what one would consider balmy. My cousin tried a few dives on his own first, and was singularly unimpressed and, frankly, a little bored by the lack of visual entertainment. It was cold and gloomy with no action in sight – he felt like the average six-year-old in the back seat of the car during a trip to the Kruger.

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Then Craig spent some time with him, coached him, gave him some pointers of what to look out for, helped him to open his mind, guided his thinking and expectations…and a whole different world opened up. Suddenly the kelp forests were teeming with life and movement. He was filled with wonder and mystery and on high alert for Nemo and Ariel – same environment, different mindset.

The movie, and the book that supported it, caught the attention and imagination of a global audience - the documentary became a viral hit. Following its release, although Netflix does not release viewer data, it was declared a global success, in the top 10 most-watched documentaries in Israel, South Africa and Australia. Amy Schumer recommended it to her 10.2 million Instagram followers.

Suddenly, everyone clearly understands the distinction between octopus and calamari…and it is not cool to eat the octopus.

It can be challenging to greet new information with an open mind. Considering the pace and the quantum of information flowing at us constantly, even the most hardy among us become fatigued occasionally…yet somehow this release made waves. Some of the reasons for this might be:

- emotional storytelling;
- stunning cinematography;
- universal themes such as the connection between humans and nature, the fragility of ecosystems, and the importance of conservation that resonate with a wide audience;
- timing: released on Netflix in September 2020, a time when many people were staying at home due to the COVID-19 pandemic, the film provided a welcome escape from the stresses of daily life and offered a unique perspective on the natural world.

So, as a provider of rules-based investment philosophy, how do we create the same sea-change in investors' minds? What keeps people from a willingness to make space for a 'new-fangled' idea?

This may seem a deeply philosophical input to a very dry, rational process, but in the words of Richard Rohr, *'transformation is more often about unlearning, than learning.'*

What is it that we need to un-learn?

Very often it is simply a resistance to change and fear of the unknown. We are often afraid of things that are unfamiliar or new. We'd prefer to stick to what we know rather than risk venturing into something unknown or untested.

Similarly, there's what behavioural scientists call cognitive bias. We have a tendency to rely on pre-existing beliefs and are resistant to changing our minds or considering new ideas that contradict our existing beliefs. We are deeply comfortable with the familiar.

This is closely aligned with the fear that if we try something new, it may lead to failure or have negative consequences and so we will do what we can to avoid that outcome.

Is any man afraid of change? What can take place without change? What then is more pleasing or more suitable to the universal nature? And can you take a hot bath unless the wood for the fire undergoes a change? And can you be nourished unless the food undergoes a change? And can anything else that is useful be accomplished without change? Do you not see then that for yourself also to change is just the same, and equally necessary for the universal nature?

Marcus Aurelius

It may also simply be a lack of information. Gathering the information necessary to embrace a new way of thinking requires energy and commitment and, based on the new information to hand, to then unlearn what may be mis-informed or outdated.

As suggested in our opening statement, let's apply this specifically to why people may be resistant to investing in index trackers. (Let's call a cephalopod a cephalopod!)

We mentioned previously that it may simply be a lack of understanding. Some investors may not fully understand how index trackers work, whereas they are quite familiar with traditional actively managed funds. Moving into the space of the unknown may be daunting.

Index tracking is often called passive investing – an investor may prefer the idea of being in control themselves, that selecting their own stocks or active fund gives them more control over their investments and this likely to achieve higher returns than simply tracking the index. Alternatively, they may have unassailable trust in an investment guru, someone that they trust completely – to the exclusion of any possibility of disappointment.

Further to this is the fear of missing out. Active investors get to indulge in a wonderful world of story-telling – the idea that they can participate in the new, new thing, the next 'hot stock' that promises great potential return, can result in a delicious shot of adrenalin.

Many investors think of index investing as a bit of a snooze-fest – nothing exciting is expected to happen and there is no reason to wait in breathless anticipation of an expected event.

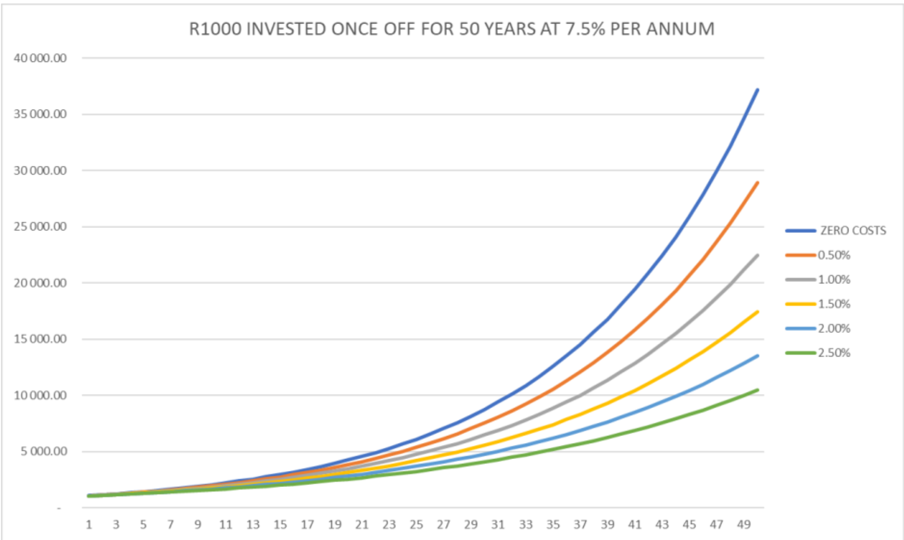
With regard to this last point, they are absolutely right! Passive investing generally involves less decision-making and activity than other investment strategies, which can make it seem less exciting or interesting. Additionally, passive investors typically have a longer-term investment horizon and are focused on achieving steady, consistent returns over time rather than trying to make quick gains through active trading.

There may also be the perception that trackers deliver lukewarm returns. What would be more accurate is to say that trackers deliver average returns, *consistently*. Index trackers should only be expected to deliver market returns, rather than outperforming the market. However, many investors reason that by selecting individual stocks or actively managed funds, they will be able to achieve above-average returns, *consistently*.

The graph below illustrates this reality:

But let's go beyond performance…

Index tracking, while not as fascinating as cephalopods, certainly does have more than one redeeming feature. Fees, consistency and liquidity immediately come to mind.



The impact of costs on an investment is broader than simply comparing annual management fees or total expense ratios.

This graph and the table below show the erosion effect of fees on an investment. If you invested R1000 once-off for 50 years, you would sacrifice 22% of your maturity value if you invested in a savings plan with costs of 0.5% per annum, and as much as 72% if you're paying an annual fee of 2.5%. Be wary of hidden costs and include all costs in your calculations – the total cost needs to be considered! Including indexation in a portfolio can help keep costs to an absolute minimum as passive funds usually have lower fees than actively managed funds.

R1000 INVESTED ONCE OFF FOR 50 YEARS AT 7.5.% P.A.					
ANNUAL MANAGEMENT FEE	0.50%	1.00%	1.50%	2.00%	2.50%
EROSION OF RETURNS	22.17%	39.50%	53.03%	63.58%	71.80%

A further factor that should be considered is the *consistency* of a fund's performance – even a broken watch is right twice a day. Being invested in a volatile fund whose performance inspires a roller-coaster ride of gasps of horror and screeches of glee, is both exhausting emotionally and destructive financially. An index tracker will avoid the feast or famine scenario – your returns simply mimic those of the market. It might not be fascinating and fun – but it is dependable, and, over the longer term, you reap the rewards. This 'sleep-well-at-night' factor beats any melatonin supplement.

And a final factor that should be borne in mind: liquidity. Overall, the liquidity of index funds can be a significant advantage for investors, making it easy to buy and sell as needed while also keeping transaction costs under control. A reliable and responsible index fund manager should ensure this in any index fund they manage.

We do not advocate indexation as being the only approach to equity investing – we wholeheartedly endorse the function of the active manager but suggest that the most effective approach is to include a selection of niched active managers supported by a core investment in an index fund.

While many active fund managers have consistently underperformed the market, the key words are 'many' and 'consistently'. There will always be active managers that outperform the market – the challenge is in selecting which ones will, when, and how long they will continue to do so.

We don't want to be the dream-stealers or the Grinch of the investment industry – but we have more than twenty years of experience in index tracking and we are passionately committed to building awareness and appreciation for the benefit of investors.

"Happiness is that feeling you get right before you need more happiness."

—Don Draper

Glacier Research would like to thank Megan Fraser for her contribution to this week's *Funds on Friday*

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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 at 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.