FUNDS ON FRIDAY
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It’s complicated

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How much attention do you pay to the ‘Terms and Conditions’ before you ‘Click to Accept’? I would venture that not many of us have the time or energy needed to wade through the miasma of small print that we encounter, particularly on digital applications – and that’s not even taking into consideration that Clicks doesn’t make the +6.5 reading glasses that many of us would need to be able to properly read the small print.

The Greeks and the Romans had this whole Buyer Beware! thing covered. Thanks to Wikipedia we know that the commonly used expression *‘Caveat emptor’* is an abbreviation of the original warning: *Caveat emptor, quia ignorare non debuit quod jus alienum emit* which means, “Let a purchaser beware, for he ought not to be ignorant of the nature of the property which he is buying from another party."

The Greeks too had their cautionary tales which warned or foretold of looming danger and prescribed prudence. One such tale that most of us are familiar with is the story of Icarus.

In Greek mythology, Icarus is the son of the master craftsman Daedalus, the creator of the Labyrinth. Icarus and his father attempt to escape from Crete by means of wings that his father constructed from feathers and wax. Icarus' father warns him first of complacency and then of hubris, asking that he fly neither too low nor too high, so that the sea's dampness would not clog his wings, nor would the sun's heat melt them. Icarus ignored his father's instructions not to fly too close to the sun; when the wax in his wings melted, he tumbled out of the sky and fell into the sea where he drowned, giving rise to the idiom "don't fly too close to the sun".

Complacency and hubris are emotions experienced not only by Icarus, but also by most human beings at various times in their lives. As stated by the indomitable Winston Churchill,

> *"Personally, I'm always ready to learn, although I do not always like being taught."*

While this story from Greek mythology may be considered by some as being far removed from modern-day living, we consider this ancient wisdom to be profound and relevant.

We believe it accurately defines not only the investment behaviours to be avoided, but also explains how important it is to navigate between the 'dampness of the sea', i.e. exposure to insufficient risk to avoid wealth being eroded by inflation, and the 'sun's heat', i.e. overly aggressive exposure to risk, which can have ruinous economic consequences.

This blinkered approach to caution and consequences works both ways. There is an fascinating report that appeared in the press in the 90's in which Hoover Europe offered anyone in the UK who spent £100 pounds on a Hoover appliance two free overseas airline tickets. Because vacuum cleaners were cheaper than international air fares, many people bought Hoovers just to get a free flight. Hoover was overwhelmed and tried to deter customers by attaching numerous conditions to the deal, but thousands fought back. This 'free flights' promotion eventually cost Hoover Europe's former corporate parent, US-based Maytag Corp, $72 million to fly some 220,000 people, while 350,000 people still had grounds to sue; Hoover battled to close out one of the most embarrassing blunders in corporate history.

This whole introductory commentary can be distilled into a simple message – understand the risk you are taking [on]. In order to do this we believe that there are three critical factors investors should bear in mind: (1) Know thyself, (2) Manage expectations, and (3) Diversification.

Know Thyself

This Ancient Greek aphorism "know thyself" is the first of three Delphic maxims inscribed in the forecourt of the Temple of Apollo at Delphi according to the Greek writer Pausanias. (Just for the sake of completeness and interest, the two maxims that follow "Know thyself" were "Nothing to excess" and "Certainty brings insanity". You're welcome.)

While this may seem an overly whimsical or deeply philosophical approach to investing, it is nevertheless critical in establishing and understanding the foundations on which investment decisions are based.

As investors we should know the following:

- What is my understanding of risk?
- How much risk can I stomach?
- How do I react to uncertainty?
- What is my expectation around certainty?
- How vulnerable am I to the drama of the world around me?
- How does investing make me feel?

While you might consider this touchy/feely stuff to be the domain of reflexologists and organic farmers, statistics on the actual behaviour of investors in times of crisis and uncertainty demonstrates a clear lack of understanding of themselves and their behaviour.

Mastering oneself is essential, particularly when things don't go according to plan. Abandoning a long-term investment strategy as the knee-jerk reaction to an emotional response must be avoided – it will most likely cause serious damage to any investment portfolio.

Hence our view: when you have the answer to these questions, write them down – it's too easy to forget the halcyon days in which those decisions were reached; making a note of them (a decision diary) is a practical, sanity-saving practice (and not just for investing).

Self-knowledge is not what humans generally do best. And so, in knowing this, in order to ensure that we build long-term wealth, we need to be acutely aware of our weaknesses and fallibilities and then manage ourselves accordingly.

Knowing others is intelligence; knowing yourself is true wisdom. Mastering others is strength; mastering yourself is true power."

Lao-Tzu.

Manage expectations

It's easy for investors to want to extrapolate recent returns into the future – who actually reads the health warnings that 'past performance is not a prediction of future returns'?

Markets, like life, are subject to the laws of nature and economics. This is why it is important to be rational and realistic with expectation of future returns. Equities can reasonably be expected to deliver inflation-beating returns over the longer term but in reality, cash has outperformed equities over the last 5 years. This tells us that there is also a time ***not*** to be in equities.

"It is the unemotional, reserved, calm, detached warrior who wins, not the hothead seeking vengeance and not the ambitious seeker of fortune."

Sun Tzu, The Art of War:

But it's not only long-term returns that need to be taken into account when evaluating expected returns. Any investor who is invested in living annuities will have felt the impact of the recent volatility in the market. For those drawing the minimum income (or close to it) this may not have been felt as acutely, but for those who have been drawing high incomes from their capital face a dilemma – either to reduce the amount withdrawn every month (i.e. reduce their income) or to erode capital.

Below is an extract from the *Corion Report for September 2022*. If investors in the funds delivering negative returns have not mitigated this loss with properly diversified portfolios, the consequences will be severely felt.

ASISA SA High Equity

ONE MONTH AS AT 30 SEPTEMBER 2022

BEST PERFORMING	SIZE	RETURN
1. Gryphon Prudential Fund	R 638	2.5%
2. Rezco Value Trend	R 6 013	0.7%
3. Element Islamic Balanced SCI	R 102	0.0%
4. Centaur BCI Balanced	R 1 518	-0.6%
5. Rezco Managed Plus	R 760	-0.8%

WORST PERFORMING	SIZE	RETURN
1. High Street High Equity Prescient Fund	R 190	-9.1%
2. Long Beach Managed Prescient	R 108	-7.5%
3. Prescient Balanced	R 3 641	-7.1%
4. Granate BCI Balanced Fund	R 122	-5.2%
5. Plexus Wealth BCI Balanced	R 213	-5.1%

LARGEST FUNDS	SIZE	RETURN
1. Allan Gray Balanced	R 152 713	-1.3%
2. Coronation Balanced Plus	R 92 938	-4.3%
3. Ninety One Opportunity	R 60 787	-3.4%
4. Discovery Balanced	R 33 792	-2.9%
5. Ninety One Managed	R 28 815	-1.1%

INDUSTRY	RETURN
ASISA SA Multi Asset High Eq Category Ave	-3.1%
Equities - FTSE/JSE All Share Index	-4.1%
Bonds - JSE All Bond Index	-2.1%

ONE YEAR AS AT 30 SEPTEMBER 2022

BEST PERFORMING	SIZE	RETURN
1. Gryphon Prudential Fund	R 638	10.3%
2. PPS Managed Fund	R 3 022	9.0%
3. Nedgroup Inv Managed	R 1 397	7.6%
4. PPS Balanced FoF	R 3 969	7.6%
5. Rezco Value Trend	R 6 013	6.9%

WORST PERFORMING	SIZE	RETURN
1. Long Beach Managed Prescient	R 108	-22.6%
2. High Street High Equity Prescient Fund	R 190	-18.5%
3. Flagship IP Balanced Fund	R 205	-7.4%
4. Centaur BCI Balanced	R 1 518	-6.1%
5. STANLIB Balanced	R 5 259	-5.7%

LARGEST FUNDS	SIZE	RETURN
1. Allan Gray Balanced	R 152 713	5.0%
2. Coronation Balanced Plus	R 92 938	-2.0%
3. Ninety One Opportunity	R 60 787	-0.1%
4. Discovery Balanced	R 33 792	-0.7%
5. Ninety One Managed	R 28 815	-0.6%

INDUSTRY	RETURN
ASISA SA Multi Asset High Eq Category Ave	0.2%
Equities - FTSE/JSE All Share Index	3.5%
Bonds - JSE All Bond Index	1.5%

No meaningful investment decisions should be made using the Report. Funds without an updated price at the time of compiling, have been omitted. Datasource: Morningstar, pre month end sign off; Minimum fund size: R100 million.

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While this might sound like a gloomy, pessimistic and rather dull approach, it is the result of hard-learned lessons and rational thinking. And, in the words of Morgan Housel,

> *Pessimism always sounds smarter than optimism because optimism sounds like a sales pitch while pessimism sounds like someone trying to help you.*

Diversification

If you're wondering how best to have been positioned for what has happened in markets, one word – diversification. This is considered by some to be the only free lunch. But diversification doesn't mean a variety of flavours of the same Kool Aid – a properly diversified portfolio means including funds that are uncorrelated to each other.

While we have written before about the wisdom of concurrently being invested in both the makers of umbrellas and the makers of ice cream, there appear to be very few investors who apply this same thinking and enjoy the associated benefits.

In the table below each number represents the relationship between the fund to the left and the fund in the top line. A number close to 1 implies that the two funds are similar, i.e. investors will get a similar return/behaviour from these funds. A number close to zero implies little or no relationship – which in this instance is good as the funds perform "differently" and deliver to the investor the desired diversification in terms of performance.

FUND NAME	FUND A	FUND B	FUND C	GRYPHON PRUDENTIAL FUND	SA MA HIGH EQUITY	SA MA LOW EQUITY	SA MA MEDIUM EQUITY
FUND A		0.92	0.92	-0.13	0.95	0.92	0.93
FUND B	0.92		0.98	-0.03	0.98	0.99	0.99
FUND C	0.92	0.98		-0.05	0.98	0.97	0.98
GRYPHON PRUDENTIAL FUND	-0.13	-0.03	-0.05		-0.09	-0.07	-0.06
SA MA HIGH EQUITY	0.95	0.98	0.98	-0.09		0.98	1.00
SA MA LOW EQUITY	0.92	0.99	0.97	-0.07	0.98		0.99
SA MA MEDIUM EQUITY	0.93	0.99	0.98	-0.06	1.00	0.99	

Positive Correlation   Low Correlation   Negative Correlation

Source: ProfileData/FE fund info
Date: Oct 2022

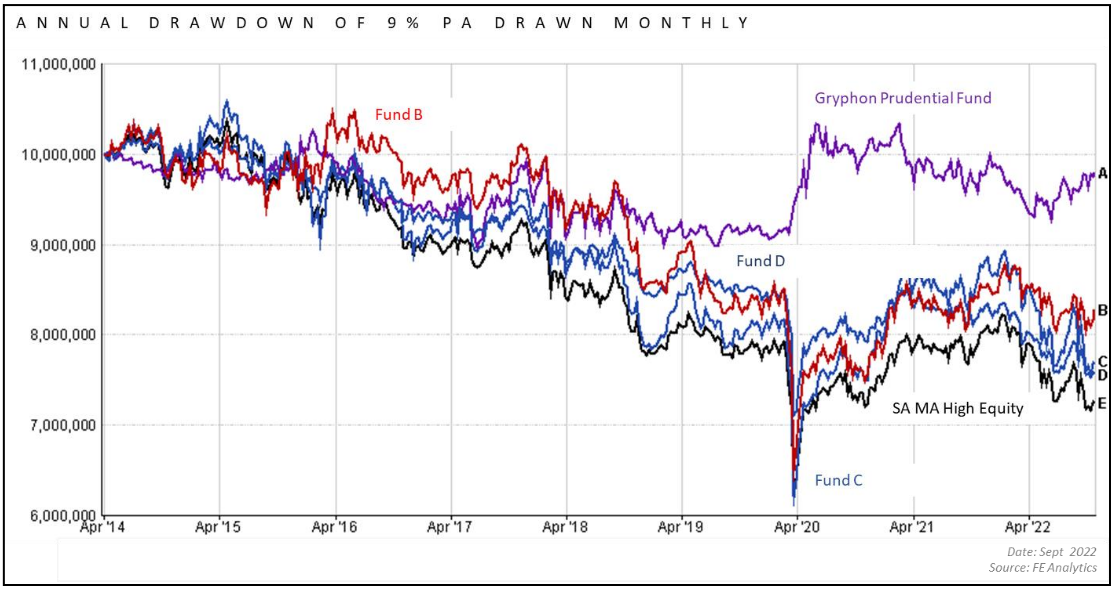
The Gryphon Prudential Funds delivers this uncorrelated performance particularly when it is out of equities, i.e. as we are at the moment, holding no equities at all.

So, having established the importance of the three aforementioned tenets - know yourself, managing expectations and diversification – what now?

Taking these principles to where the rubber really hits the road – living annuities. This type of investment is commonly considered to be the "bread and butter" of South African investors and is fundamental to the financial well-being of many retirees. While this is a beneficial concept, it's efficacy is dependent on the choice of underlying funds, i.e. if these funds do not deliver adequate returns to support the required income, investors' capital will eventually be affected and ultimately depleted.

The two graphs below illustrate the impact of volatile markets on returns – the purple line is the return of the Gryphon Prudential Fund against the larger three funds in the category and the average of that category which is SA Multi Asset High Equity.

The first graph presumes an annual drawdown of 9% per year drawn monthly, and the second graph an annual drawdown of 4% per year drawn monthly:



While there may be no defined finishing line for investors, for those who have diligently squirreled away their hard-earned savings, it is reasonable to expect to be able to reap the rewards of their prudence and receive a regular, dependable income.

Our purpose as an asset manager is to provide a solution to meet those expectations – a solution that is simple, affordable and effective. There is no single product that is going to keep all investors happy all of the time but there is the option to create the alchemy that can deliver this outcome for those invested in living annuities - diversification. The challenge is in moving beyond the common and the popular and including funds that will zig while the others zag.

In conclusion, more wisdom from by Morgan Housel, *Baseball player Dan Quisenberry once said,* "The future is much like the present, only longer." *I like that idea and think it has two takeaways. One, by the time one problem ends a new one has already arrived; there's no glorious time when everyone can relax. Two, the scenes change, but people don't. They're motivated and flawed the same way today that they were 100 years ago and will be 100 years from now.*

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

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Reuben is Gryphon's Chief Investment Officer, Chair of the Gryphon Investment Committee and is co-manager of the Gryphon Dividend Income Fund, the Gryphon ALSI Tracker Fund, the Gryphon Global Tracker Fund and the multi asset funds. Having served as the Head of Strategy, he has broad experience covering most asset classes. He has been an industry professional since 1996, has commercial and accounting experience, is a Chartered Accountant and is a Chartered Financial Analyst Charter holder.
Reuben is a self-confessed, unapologetic coffee snob as well as being an avid gymmer and cyclist.

Megan Fraser,
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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, SI, 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.