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One persistent threat to your investment strategy

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Investors are losing their minds at the moment! Coronavirus is grinding the Chinese economy to a halt and markets are falling hard. Coronavirus is occupying a lot of space in the minds of many investors, space that used to be occupied by issues such as US-China trade wars, a Trump presidency, Brexit, PIIGS, Grexit, QE, state capture, credit downgrades (although that is making a comeback), etc. Market commentators describe these passing issues as noise, and while they have a short-term impact on markets, they often fade into memory as a new hip and happening issue comes to the fore. Successful investors tend to ignore or add little weight to these issues and focus on long term principles and ongoign analysis of what really matters.

As a financial planning practitioner, I have had many discussions with clients and prospective clients over the years around the strategies we need to adopt to meet their investment objectives. These objectives include building enough retirement capital, going on that extended holiday, saving to fund education, a deposit for that dream home, and general long-term wealth creation. These are ultimately the things that we want our money to do for us, that bring us joy, and that add meaning to everything. This is why we invest.

The reason we do not achieve these objectives though has almost nothing to do with the choice of funds we invest in, active or passive management, value or growth, small or large caps, or any passing issue which is dominating news headlines. Often investors get tripped up by something as simple as not running their financial affairs with a budget. The simple budget remains the foundation and cornerstone of wealth creation. It's simplicity often hides its importance and impact.

Notice how few people get excited at the work done on the foundation of a new building. Most people want to see what the building will look like when it is done. Preparing the foundation is dirty work. It involves excavation, rubble removal, digging deep holes and pouring tons of concrete. It never looks good. Yet, without a proper foundation, it matters little what the building will look like. Ultimately it will come crashing down or be torn down due to safety concerns.

It is budget season now with Finance Minister Tito Mboweni dominating headlines. It amazes me that countries and companies spend a lot of time and effort compiling their budgets, yet individuals mostly tend to ignore or avoid them altogether. A Gallup survey in the US found that fewer than 31% of households there run a budget.

Read any Sanlam Benchmark Survey, Alexander Forbes Benefits Barometer or Old Mutual Retirement Monitor survey and you will see the dire statistics around members withdrawing their retirement savings when changing jobs. It was a key issue identified in Treasury's Retirement Reform programme. Scratch below the surface and financial distress and over indebtedness are the main reasons for this behaviour. Withdrawing retirement savings in the accumulation phase destroys more retirement plans than Regulation 28 ever could. Investment strategy doesn't even feature as a reason for members withdrawing their funds.

I met a client recently who had been saving less than R50 a month since the mid 1970's in a bank product. I asked him how he maintained that commitment for so long. Simple, he said, "it went into my budget on day 1 and stayed there". I did some analysis and found that had he invested that money into the stock market the investment would have been worth more than double what it was. However, it struck me that because he had put money away in the first place, there was now an amount over R1m there that he could use in his retirement (it was a small part of the total retirement pot). Too often we get caught up in chasing strategies that will give us the best return, that we get paralysed and end up doing nothing at all. It was in fact his habit of budgeting that resulted in him retiring with more than enough capital. That is what put him into an elite minority of retirees, not whether he invested in shares or money market.

When done properly, the budget is a rich source of information. A simple observation of income versus expenses will alert one to a coming debt crisis. Classifying spending into consumption and investment and one can see whether they will have anything to show for their money in a few years' time. A more sophisticated budget will facilitate stress testing to see the impact of rising interest rates on debt repayments and the overall budget. If one of our financial objectives is to secure our children's financial future – is there education savings or life cover in the budget? If not, then it is a dream.

Coronavirus is a concern and a serious matter. However, it is unlikely to threaten any investor's objectives and goals quite like the absence of a good budgeting habit. It trumps the power of any US president – past, present or future.

Should you want to discuss further contact:

Craig Gradidge CFP®
Tel 010 448 2200
Cell 079 885 6215
Email craig@gminvestments.co.za

Wynand Gouws CFP®
Tel : 021 204 2920
Cell : 082 450 7386
Email : wynand@gminvestments.co.za

28 Fricker Road, Illovo, 2196
T 010 448 2200 F 086 212 6459 E info@gminvestments.co.za

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www.gminvestments.co.za
Gradidge-Mahura Investments is an Authorised Financial Services Provider
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