FNB Media Release

Turning to unit trusts in times of volatility

By Nicholas Riemer, Investment Education Head, FNB Wealth and Investments

Unit trusts can be a fantastic instrument for the beginner investor, looking for access to the markets but through a professional fund. However, post any emergency or crisis, unit trusts can be used by a variety of long-term investors regardless of their market knowledge. The markets have experienced extreme volatility on the back of the COVID-19 virus and we have seen companies take the necessary and drastic steps to try and stabilise if not bring it back to some sort of normality.

South Africa and the rest of the world are in an economic crisis. Companies have seen huge pull backs in share prices as a result of the virus concerns. However, looking back at market data, the JSE has been able to recover from previous events in a much shorter time frame. The 2008 financial crisis saw the JSE Alsi lose 41% towards the end of 2008. However, 1 year later and the Alsi was up 48%, 3 years 101% and 5 years post the crisis up 194.4%. A well-diversified portfolio can serve a long-term investor well post a crisis as seen looking back at the 2008 crash.

Exposure to the correct shares and assets can yield very attractive returns post a crisis, but diversification is key:
FNB Media Release

Diversification is that one word heard repeatedly in times of extreme volatility. Reason being, that diversification can reduce potential losses when done correctly. Diversification however is not an exact science and requires market and financial knowledge. Simply increasing the number of stocks in a portfolio does not assist in balancing portfolio risk, as increasing shares is only effective to a certain point as seen on the graph below:

*Limits of diversification in equity-only portfolio*

![Graph showing the limits of diversification in equity-only portfolio](image)

*Source: Raskeduction*

Portfolio risk can be reduced through diversification, however investments in different stocks is only effective to a certain point. Beyond that point additional increases in instruments provides no benefit in spreading portfolio risk.
FNB Media Release

Thus, multiple asset class selection (equities, property, bonds and cash), geographic locations, sector differentiation, market caps and growth phases must all be considered when diversifying a portfolio correctly.

How well a portfolio is diversified comes to light in times of volatility. Any cracks in asset selection will only come to light when markets are down. Current market unrest due to COVID-19 concerns has seen many portfolios liquidated and cash removed from the market. A typical cycle sees investors investing in the market during the good times and removing funds from the market in times of difficulty. Unfortunately, this results in many investors investing in times when prices are high and exiting when prices are low.

The main reason is attributed to investors being fearful that further losses will be incurred. Long term investing is only effective when invested funds are given long enough to ride out market fluctuations. This is made a lot easier when diversification is done correctly as losses are balanced as opposed to single asset fluctuations.

Those investors without the necessary market and financial knowledge turn to professionals for assistance in the likes of portfolio managers. This is one way to potentially diversify a portfolio, however as with anything in life, it costs a premium fee to have this professional service and normally requires a certain threshold of wealth. There is however another cost-effective option to invest in the market in a diversified manner and that is through unit trust funds.
FNB Media Release

Unit trusts, in particular multi-asset funds, offer professional fund management and access to the market through a basket of well-diversified instruments. Investors have different options to match their specific risk appetite and long-term investment goals. Unit trusts are for long term investment and must be given time to outperform inflation on an annual basis and overcome short term market fluctuations. Hopping in and out of unit trust investments is not a method to achieve long term sustainable returns.

The below graph shows the unit trust investment cycle during the 2008 financial crisis:

![Graph 1: SA Investors miss out on equity rebounds](image)

During the build up to the financial crisis in late 2007 and early 2008, South Africans began withdrawing funds from multi-asset and equity unit trusts and placed them in money market and bond funds. The market proceeded to crash in September 2008 with the JSE ALSI down 20.6%. The JSE began to recover at the beginning of 2009 however South African investors still chose money market and bond funds over multi-asset and equity unit trusts.
FNB Media Release

This meant investors missed out on the equity and JSE rebound. It was only mid-way through 2009 when investors woke up to these potential returns and began investing in Unit trusts again. However, as discussed above these investors sold at low prices and then re-entered the markets when prices were high again.

When investing in a multi-asset unit trust, the fund has been designed in a way to beat inflation and achieve sustainable returns over the long term. Looking at data from the Association of investments and savings South Africa (ASISA) reveals that the 10 largest balanced (multi-asset) funds offered investors 10.3% average return per annum over the last 10 years as of January 2020. Those removing funds in times of volatility over the last 10 years lost out on these returns.

Investors selecting multi-asset unit trust to have market exposure must have faith in the fund composition and the professionals that compile the fund. Long term investing means staying invested through the volatile times and allowing the fund to achieve returns over the long term.

ENDS//