Put everything on red!

There is a loud cheer (or is it a groan) at one of the roulette tables in the center of the casino. A middle-aged man with a neat hairstyle and George Clooney-like facial features approaches. He sees what the consternation is about. The board above the roulette table indicates that the last 11 numbers were all BLACK. The man puts his hand in his pocket and hands a stack of R100 notes to the dealer and says confidently: "Put everything on red". The dealer takes the money and puts R10 000's "chips" on red. The excitement around the table is overwhelming and before the dealer spins the white ball there are some bystanders who imitate George and put money on the red block. The excitement attracts a bit of a crowd and everyone looks admiringly at the man at the end of the table, cool as a cucumber while watching as the white ball spins round and round. Then the ball begins to bounce from one slot to another and eventually comes to a halt. **13 Black** shouts the dealer! The crowd gasps as the dealer rakes together the R10 000 in chips, while the man turns around and walks towards the casino's exit.

You cannot know for certain what you cannot know with certainty. In investments, it's a lesson that many fund managers, advisors and private investors have learned the hard way. South Africa is certainly in one of its most challenging political and economic times ever. You must go far back in time to find a period of greater pessimism. Emotions are running high and while they are a social prerequisite for funerals, weddings and some other events it is something you should avoid when investing.

The "take everything abroad" message seems to convince many investors that a good outcome will be achieved with certainty. This message has gained momentum over the past few months and two very prominent figures have expressed strong opinions on this issue over the past two weeks. To be fair to people who convey this message, it's something they've been saying for a long time and you must admit that following this advice (if you applied it 5 years ago when they first said it) would have delivered good results. And let's be honest, it's what people want to hear! People do not want to hear half-uncertain opinions from experts in times of massive uncertainty. They are looking for guidance. When you want to incorporate negative or positive sentiment (and economic data) into investment decisions, it would be advisable to consult history about how these sentiments correlated with real outcomes.

- During the period in which Nelson Mandela was our President (a period of great optimism), the JSE yielded little more than 10% per annum compared to the World Index's 34% per annum. During the period since Jacob Zuma has been our President, the JSE yielded an average return of more than 16% per year against the World Index's less than 10%.

- The last time when the consensus was that you should take all out of SA and invest abroad (2001), SA shares in the 7 years thereafter yielded an average return of more than 22% per annum while foreign shares in Rand terms over the same period have yielded exactly 0%.

- There is evidence that there is no correlation between the economic growth rate of a country and its stock market performance. Thus, a country may grow by 6% year on year, while its stock market will not go anywhere while another country grows at 1% a year, but its stock market is doing well.

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- Brazil, with a larger debt burden than SA and arguably a country with similar challenges around corruption and low growth has achieved share market growth of almost 27% in dollar terms over the past year (until the end of September) while Turkey who was still seen as a basket case just the other day had grown by 33%.

- When you take your money abroad, what are you doing? Do you only buy dollars? If so, you will invest in the asset class that have yielded the poorest returns from 8 asset classes over the last 20 years. If you invest in a typical index or foreign equity fund, your exposure to the US stock exchange is likely to be close to 60%. This is a market that currently only imports good news and is trading at an all-time high. I am not trying to insinuate anything about short-term direction of the US stock market, but just want to point out that you are not buying in at low levels.

- The SA market looks very expensive at the same time, but when the impact of the 5 largest companies (mainly Naspers) is removed, a whole different picture emerges.

What I am trying to say is, just as it seemed logical to the guy in the casino to put everything on RED, it seems logical to give up on SA markets and take everything offshore. Aside from the technical complications associated with such a strategy, I would argue that history has taught us that perception and reality are often not aligned and that markets often respond in a way that contradicts what we thought or felt was logical.
Asset allocation, in my opinion, remains an unemotional valuation process with your long-term goals in mind. I agree that the majority of South Africans have far too little exposure to foreign assets, but how, when and what you are exposed to is a process that needs to be undertaken calmly and carefully.

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