More of the same

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Charlie Munger and Warren Buffett do not attribute their success over the years to mere intelligence. In fact, it's more about avoiding mistakes. Charlie Munger, confirmed: "*It is remarkable how much advantage we have gotten by trying to be consistently not stupid, instead of trying to be very intelligent*". This statement may seem obvious, but in the investment world if you ask anyone whether they're being stupid, they would most likely reject the claim. Unfortunately we don't always realise when we are making a mistake. When it comes to financial planning and investing, we might think we are smart, but often we are not well informed enough. We really don't know what we don't know and perhaps we confirm our own biases.

The investment process is not a solvable problem – **there is no magic formula**. Neither is it a closed electric circuit with an ON and OFF switch. **There are no secrets.** Investing is the perfect example of a complex problem with no known solution. If there was a solution, someone would have mastered it. This is why there will never be a quick or easy way to get wealthy (if there was, everyone would be rich by now). Think about the multitude of problems the world faces today. If any of these problems were easy, it would have been solved. This means that only the hardest and most complex problems remain.

The investment "secret" is pretty straightforward, but few follow the advice because it is too simple: **Live with less than what you earn, save the difference, manage your tax and remain patient.**

A tribute to Charlie Munger

This investment guru and long-time business associate of Warren Buffett recently passed away in Los Angeles. His ability to succinctly describe investor behaviour was remarkable. He was revered for his accurate assessments on life and investments. His mind was crystal clear and he often surprised audiences with his counterintuitive wit and wisdom. Being very critical of Wall Street (representative of banks and brokerages in the US), Mr Munger was certainly not everyone's cup of tea. "*If it is trite, it is right*" was a favourite quote. It is about sound principles that will never go out of fashion – the fundamentals (also see our letter of August 2021). The basics are often simple things, but not necessarily easy to emulate. I was fortunate to attend the Berkshire Hathaway shareholders' meeting twice in Omaha, Nebraska. There I met Kokkie Kooyman of Denker Capital. Here Kokkie reflected on the legend, Charles T. Munger.

Volatility and performance in perspective

There will always be a good reason to sell out, or avoid market movements. Macroeconomic noise around recessions, wars etc., fuel fear and greed amongst savers. Global news flow increases trades which often are counterproductive. Warren Buffett famously said that the **stock market is a mechanism to shift wealth from the impatient to the patient.** Think about that. Could we possibly regret a knee-jerk reaction?

What lesson do we take from this?

- As difficult as it may seem, embrace uncertainty and volatility – it is out of our control;
- Volatility is the price we pay for long-term returns;
- There's a big difference between how something should work in theory versus how it actually works in the real world; i.e. when technical facts meet our human emotion;
- Financial markets (local and abroad) can and do move sideways for extended periods of time. We saw this in the United States between 2000 and 2010 (Dotcom, 9/11 and the financial crisis of 2008);
- Investing outside South Africa (ZA) is an important consideration in order to diversify, but it does not necessarily guarantee superior investment returns;
- If compared to the past, some listed South African companies on the JSE appear relatively cheap, but the risks are also high.

The risk of not taking enough risk

During COVID in 2020, the SA Reserve Bank (SARB) cut interest to the lowest level in 50 years – to boost the economy following the devastating economic consequences. Although this was good for the borrowers, it was bad for savers and retirees. Now, interest rates are high again and the opposite is true.

Behavioural finance is well documented. It is a known fact that investors favour asset classes (cash, property etc.) that have recently performed well (a hindsight bias). The converse is also true, with poorly performing strategies experiencing an exodus. Sometimes there are good reasons for being a contrarian. The risk is that long-term investors who disproportionally allocate funds for "safety", will be locking in under-performance for the next 5 years. Also, remember that we pay income tax on interest earned. The only exemption we have is R23 800 and R34 500 if you are 65 and older. The remaining interest earned is taxed at your marginal tax rate. Being too conservative translates into the probability that someone might lose future purchasing power.

Taxability, retirement fund savings and returns

When you **consider high marginal tax rates (e.g. above 35%)**, it is unlikely that an after-tax investment will outperform a registered retirement fund within a period of 15 years, even if your real return (after the effect of inflation) is double that of a retirement fund. The simple reason is that you start with a shortfall after tax. A simple calculation looks like this:

- A contribution towards a registered retirement fund of R100 should compound at a real rate of 4% per annum. After 15 years you could have R180;
- An after-tax investment starts with an investment of R65 (R100 minus the 35% tax). If we achieve a higher real compound rate of 6% per annum, you only end up at R155 after 15 years – a shortfall of R25 and without provision for capital gains tax (CGT).

Keep in mind:

- Retirement funds grow without a tax burden. Correct, no dividend tax (DWT), capital gains tax (CGT) or any tax on income (INC) within the fund;
- New Regulation 28 amendments allows us to invest up to 45% outside ZA;
- They do not form part of your estate; i.e. no estate duty and the distributions to heirs are not subjected to executor fees;
- Saving regularly towards a registered retirement fund could materially enhance overall performance and diversify a retirement plan.

What action should we consider?

Stick to a financial plan. We support a sensible approach and consider retirement contributions part of a sound planning strategy. Any saver needs a healthy discretionary investment (over which you have full discretion) as well as a retirement fund where you may **harvest annual income tax benefits that SARS offer you before the end of a tax year in February**.

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