



Platform

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Independent Insight in an Uncertain World

PIEXUS

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DINOSAURS AND VOLCANOES

On a recent Dad's morning out with the kids, we visited the Cape Town Museum. Among the wide array of exhibits vying for our attention was a display that caught the interest of my two-and-a-half-year-old son. It was a rather gory model of an attack by two prehistoric beasts with unpronounceable names on a hapless dinosaur victim. The backdrop to the scene was a forbidding landscape complete with volcanoes furiously erupting in the distance.

This scene obviously left its mark on my son. I'm not sure what work he will do one day, but we can safely scratch palaeontologist and volcanologist off the prospective careers list. He now regularly reminds me, "Daddy, I don't like dinosaurs and volcanoes!"

My son's response got me thinking about how we experience the world of investments. In the past few years, visitors to the museum of financial history have witnessed some pretty gruesome exhibits too. Sub-prime, Lehman Brothers, Northern Rock, AIG, Bernie Madoff, Greece, the Eurozone, Sharemax – dinosaurs and volcanoes!

It's interesting to ask the question whether perceptions of the investment world have changed since 2007, given recent events. Few would argue that the average man has developed a healthy mistrust of the financial services industry in general. Perhaps the question should be whether investors view risk and specifically risk taking in the same way as they did previously, or whether a new interpretation or understanding of what risk actually means has emerged.

Behavioural finance suggests that recent negative experiences and natural loss-aversion tendencies will cause people to view the world in a more pessimistic light after periods of uncertainty. It is my opinion that investors have undoubtedly lowered their tolerance for risk a notch or two. Risk is being understood less in a technical sense but with a more practical interpretation, i.e. the permanent loss of capital.

Two recent national roadshows provided me with ample opportunity to conduct an informal survey of the perceptions of professional investors and advisers around the country. It appears that there are dinosaurs and volcanoes aplenty. The level of concern is high and the average investor appears moderately to severely pessimistic about the outlook for the next few years. A fragile Eurozone and very low developed-market yields provide rational support to these concerns. Domestically, political concerns appear to dominate the headspace.

While we don't have any ideas about when or how the major risks in the world will be resolved, we do know a sensible investment framework will

uncover good opportunities regardless of the broader risks. The safe bet is that developed-world countries will contribute proportionately less to global GDP in future. Conversely, the developing world will contribute more. This trend will occur because global demographic and economic fundamentals are shifting in favour of the less-developed world.

China, India and the eight other most populous emerging markets account for 51%* of the world's population, but less than 10% of its consumption. However painful the process may prove to be, the US, Japan and the Eurozone will work through their well-catalogued series of issues. The result will imply a systematic decline in their collective standards of living. Conversely, as the 51% "poor" increase their consumption levels, their relative living standards will improve.

Our view is that collectively the world has no interest in seeing a complete collapse of the global economic system. Moreover, we are probably closing in on the end game in the Eurozone crisis and the Germans and Chinese will ultimately accept their roles as "cheque writers". In short, we believe self-preservation will demand that a solution be found. How much of this is priced into markets is anyone's guess, but we suspect that in high-yield credit, corporate credit and good-quality value shares, a decent margin of protection exists to protect against the threats.

Accordingly we think that longer-term investors, who can stomach the next three years' volatility, will see their asset price growth outstrip inflation in a diversified portfolio of risky assets including equities, commodities, property and bonds.

Not all dinosaurs need to be scary. So in the meantime, I will be telling my son about that friendly purple dinosaur whose mantra is "sharing is caring". Let's just hope there are no unexpected volcanoes!

* Based upon World Bank 2010 statistics