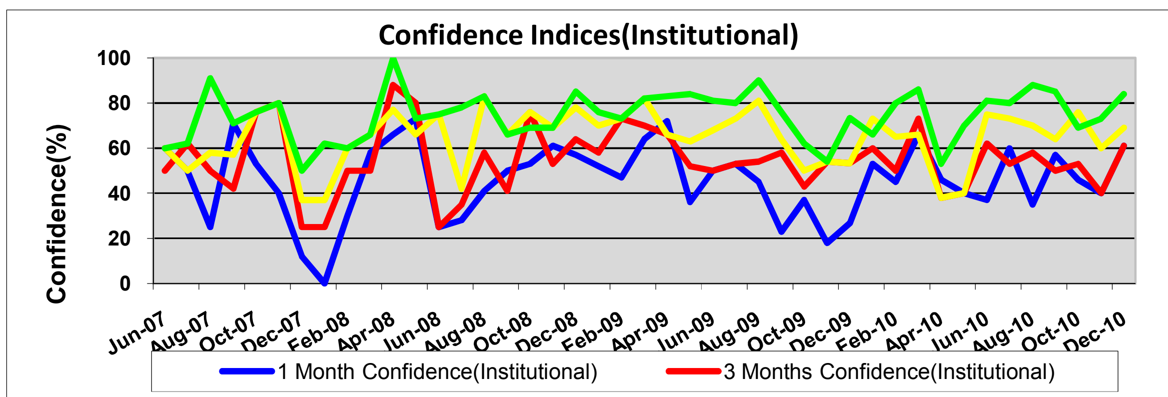
Investors finally escape the negative outlook that dominated most of 2010

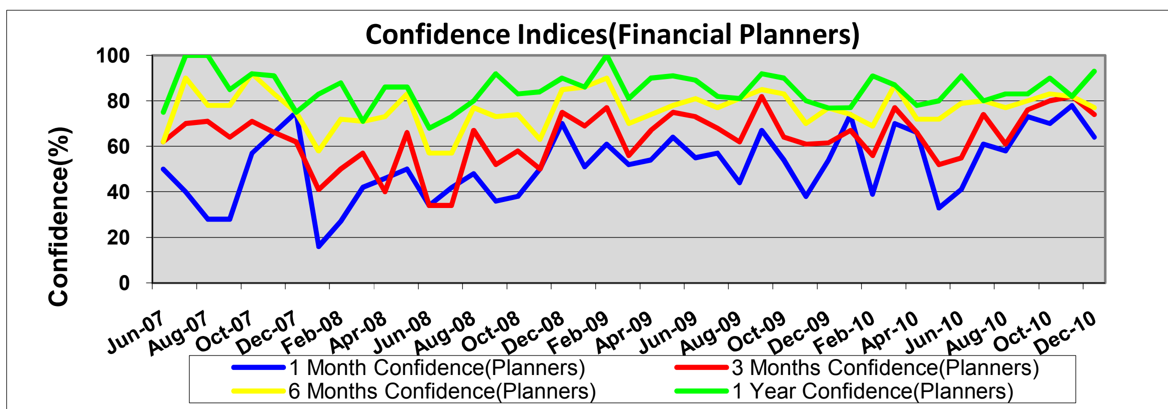
Comments by Candice Payne, Sanlam Investment Management:

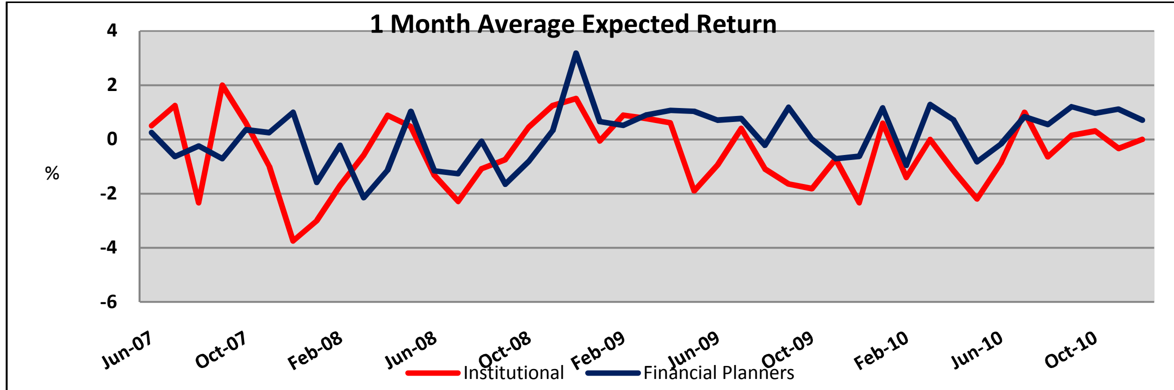
Investors are exhibiting some Christmas cheer ahead of the holidays, with an improvement in short-term optimism about potential one month equity market returns. This tick up in sentiment has occurred despite prevailing concerns about European public debt woes. In fact, as we stand at the end of 2010, it is unnerving that a lot of what we had to say at the end of 2009 hasn't changed. Although optimism is seeping through from market participants as they cling to snippets of good news emerging in economic data, we still need to remember that we are recovering from the worst financial crisis in the post-war era - and that takes time.

So as another year passes with all the concomitant volatility, excitement and disappointments, it is comforting to note that investors are still relatively positive. This is probably because the South African equity market has delivered approximately 17% year to date against an inscrutable backdrop.



Confidence among all participants in the SIM Investor Confidence Index survey reached a low point in May this year, with only 50% believing stock market performance would be positive in the following three months. This has now risen to a much higher 70%. Interestingly 90% of respondents expect positive stock market performance over the next 12 months.




1 Month Average Expected Return
4
2
0
-2
-4
-6
%
Jun-07
Oct-07
Feb-08
Jun-08
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Jun-09
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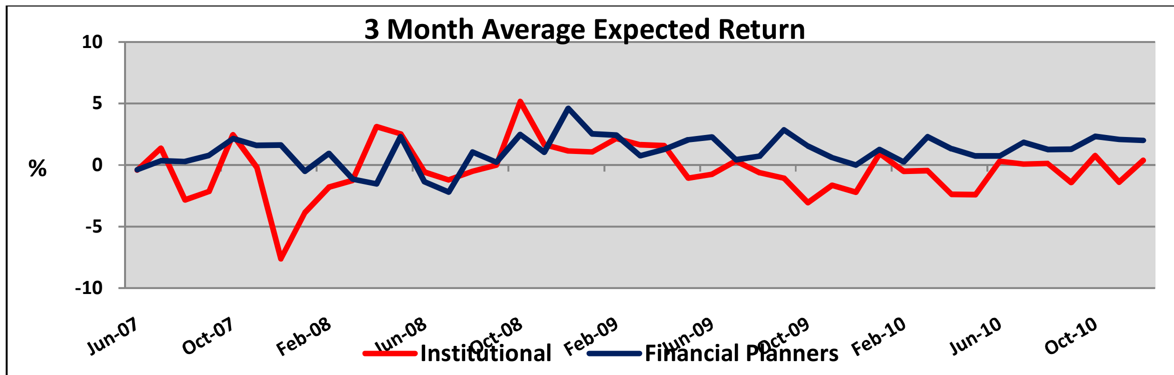
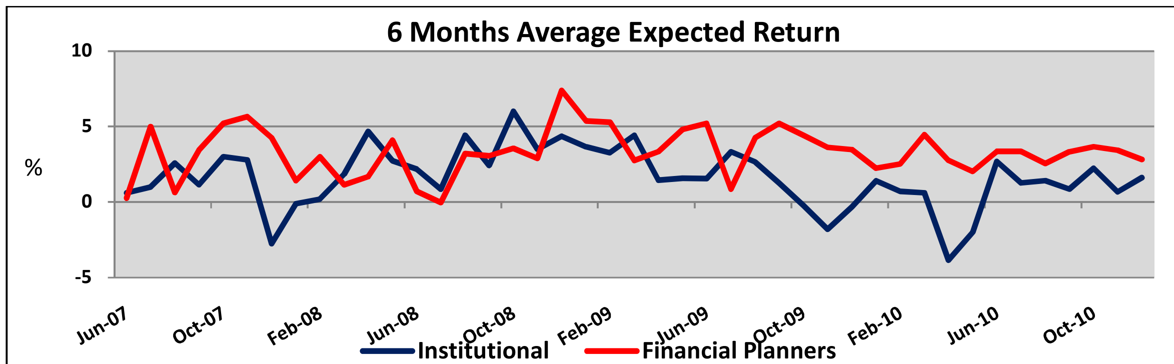
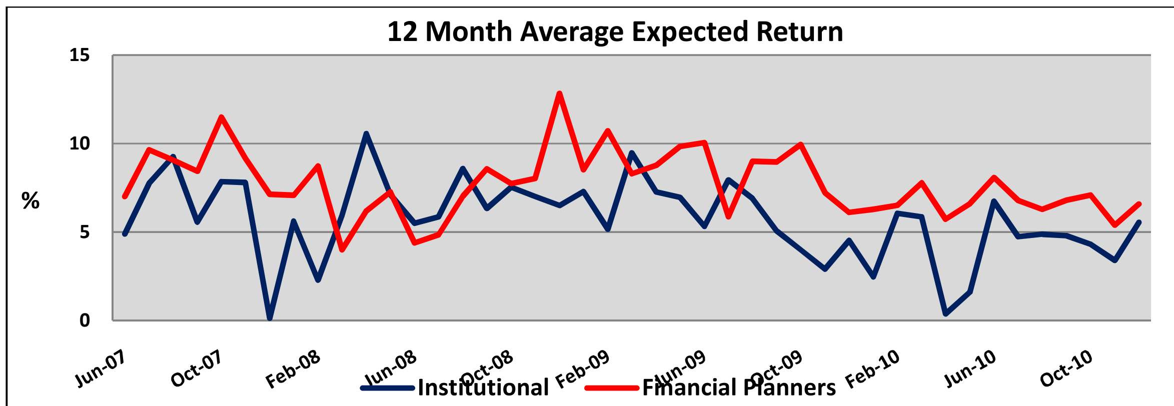
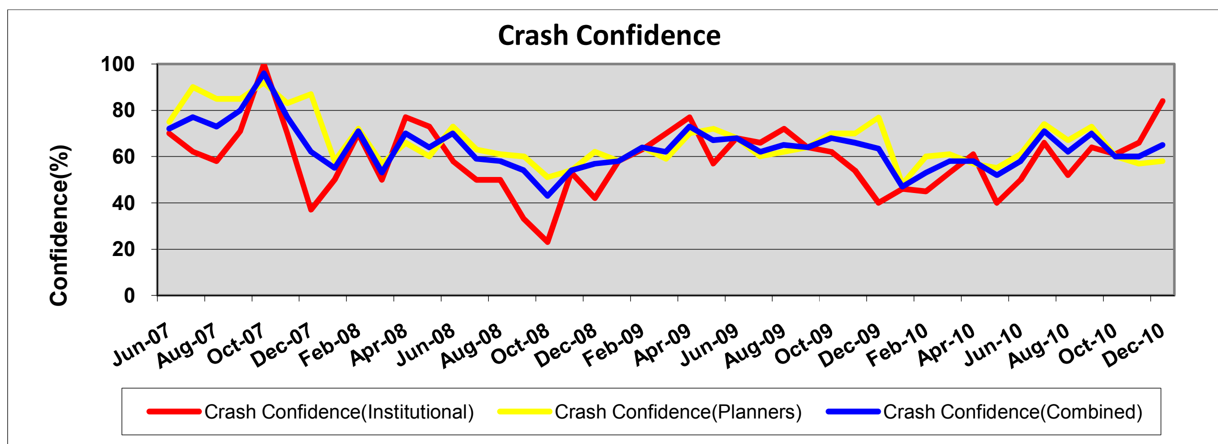
Institutional
Financial Planners

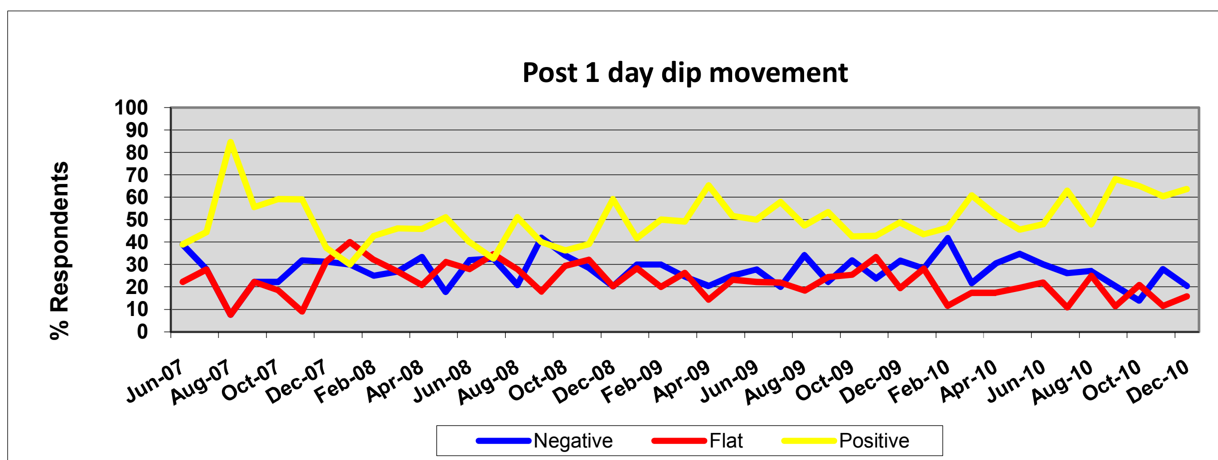

3 Month Average Expected Return
10
5
0
-5
-10
%
Jun-07
Oct-07
Feb-08
Jun-08
Oct-08
Feb-09
Jun-09
Oct-09
Feb-10
Jun-10
Oct-10
Institutional
Financial Planners


6 Months Average Expected Return
10
5
0
-5
%
Jun-07
Oct-07
Feb-08
Jun-08
Oct-08
Feb-09
Jun-09
Oct-09
Feb-10
Jun-10
Oct-10
Institutional
Financial Planners


12 Month Average Expected Return
15
10
5
0
%
Jun-07
Oct-07
Feb-08
Jun-08
Oct-08
Feb-09
Jun-09
Oct-09
Feb-10
Jun-10
Oct-10
Institutional
Financial Planners

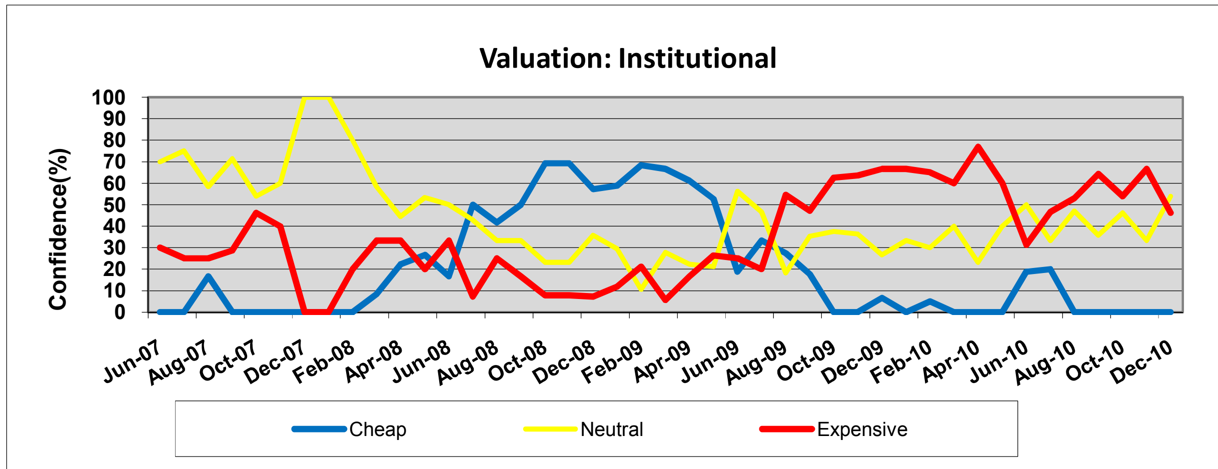
This optimism is also reflected in the Crash Confidence Index. This index shows the percentage of respondents who think that the probability of a catastrophic market crash occurring in the next six months is less than 10%. Currently 84% of institutional investors consider this probability to be less than 10%. This is by far the highest reading since October 2007 when it stood at an 'exuberant' 100%! Confirmation of this improved sentiment can be seen in the Buy-on-Dips Index. If the JSE All Share Index were to drop by 3% tomorrow, 63% of respondents expect that it would respond positively the day after. This contrasts starkly with a 38% response in April 2010 and 25% in September 2008 at the time of Lehman's demise.

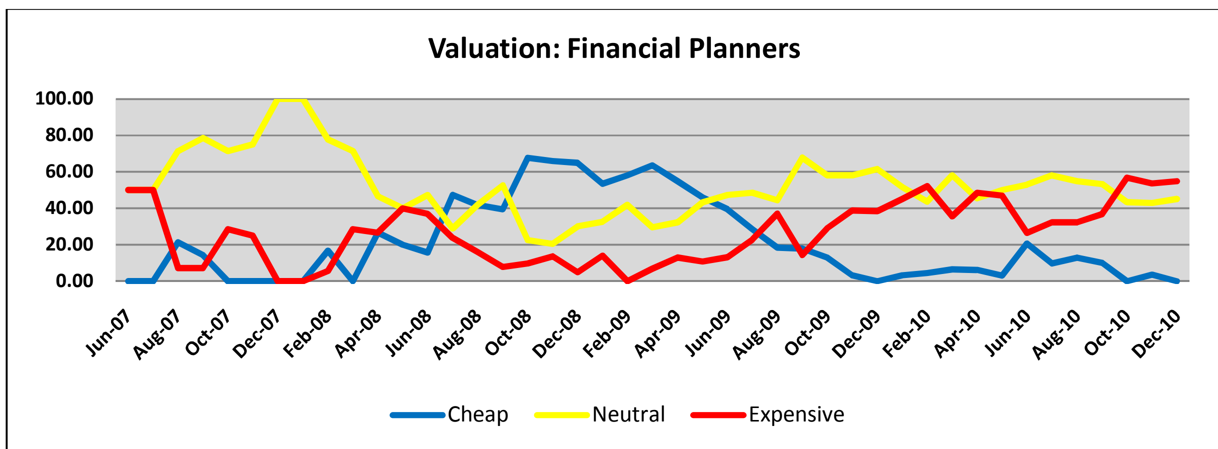




Despite creeping confidence, no one sees the market as cheap. In fact, at the margin both financial planners and institutional investors are divided on whether the market is expensive or just trading at fair value.

So what is an investor to make of a 'fairly valued' market? Well, it is important to remember that in the near term a share's performance on the stock market may be driven by changes in expectations and sentiment and not necessarily by anything the company has done. So an investor needs to approach such an investable universe with caution.





In this environment, a good fund manager will still be able to identify stocks that are trading below their intrinsic value, but on average most stocks are trading at fair value and some are expensive. What is important is to take the emotion out of investing and stick to a disciplined strategy that involves not overpaying for assets and investing for the long term.

Comments by Cobus du Plessis, Marketing Director Institute of Behavioral Finance:

Looking back to December 2009 the respondents were then, similar to December 2010, fairly evenly divided on whether the market is expensive or trading at fair value. At the time respondents expected the average annual return over the next 12 months to be around 5.5%. Year to date the market delivered close to 17%. The fear of losing money or loss aversion was probably the biggest reason why most South African investors chose to remain in fixed interest funds during 2010 and losing out on the better returns that equities offered during the period.

Looking forward respondents expect the market to end 6.3% higher in 12 months time. With investor sentiment and future return expectations very similar to that in December 2009 one should probably ask yourself whether the next 12 months (2011) will be different than during 2010. A comparison

between actual market returns and respondents' 12 month average expected returns show that future predictions are no measure for deciding whether to invest in the market or not.

We can merely express current sentiment and can therefore only advise investors to exercise caution in their investment decisions during 2011in order not to fall prey of fear and greed. Have a definite investment plan which include:

- Your investment goals and the amount of risk you need to take to reach these goals (risk required);
- How much of your capital you can risk to lose without affecting your lifestyle (risk capacity); and
- Your risk tolerance (which is a psychological trait).
- Your behavioral biases. Know the cognitive and emotional errors you are bound to make during different market conditions.

All of these may require different levels of investment risk to be taken and with the help of a good financial planner you will have to bridge the gap between the different types of risk. Your financial planner will also be able to help you construct an investment portfolio consisting of a balance between cash, equity, bonds and property based on the various risk elements and biases you may display.