INVESTMENT SERIES FOR MEMBERS AND EMPLOYERS OF THE MOTOR INDUSTRY RETIREMENT FUNDS

During this difficult time in our history as a country and society it is sometimes tempting to stop focussing on achieving our long-term goals and objectives and rather concentrate on satisfying only our day-to-day existential needs. This, however, is a very risky and treacherous path to follow because it inevitably leads to poor outcomes for yourself – this is particularly the case with our finances and money. In order to achieve reasonable long term savings it is vitally important that you start saving at a young age and are not tempted to dip into your retirement savings before you retire. Of course, you want to achieve good returns on your money too and the best way to do this is by investing in the various types of assets available in our market.

Our financial markets have grown quite complex in the last few years – there are many different investments that one can make from which you can benefit, but there are just as many from which you can lose your money. Therefore, it is important to get at least a basic understanding of the various types of investments there are in our market and how they work – this will assist you better understand our economy and also help grow an understanding of our financial markets.

As a member and participating employer in our retirement funds we believe it is important that you understand our financial markets and the various kinds of investments available to you and your retirement funds. In order to start this process, our funds have teamed up with our investment consultants – Riscura – to provide you with some basic concepts and understanding of our financial markets. In this first series Riscura describes to us the various asset classes available to us to invest our money. You may ask why this is important – the answer to this is the old adage about diversification and the lessening of risk,

"Do not put all your eggs in one basket"

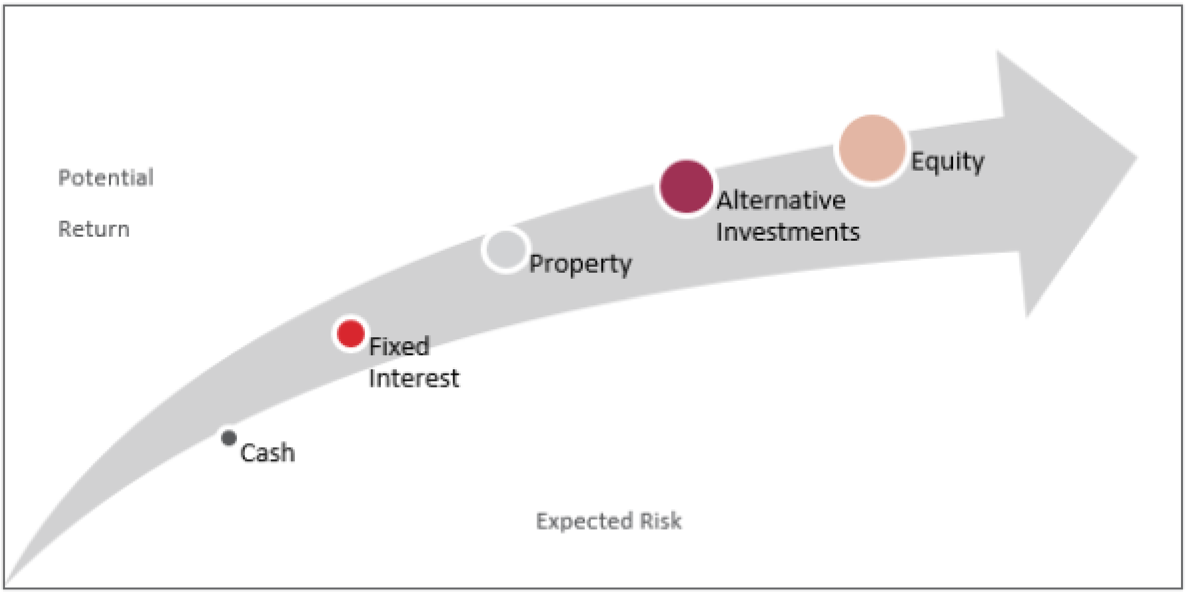
I trust you will enjoy this introduction to investments.

Radesh Maharaj
Principal Officer
19 June 2020

THE ROLE OF DIFFERENT ASSET CLASSES IN A DIVERSIFIED INVESTMENT PORTFOLIO

There are four major asset classes which are traditionally recognised as the building blocks of a diversified portfolio: Equity, Bonds, Property and Cash. Within each asset class, there are also further sub-asset classes (for example Emerging Market Equity within International Equity or Government Bonds, Corporate Bonds and Inflation-linked Bonds within Bonds). Asset classes can be local (South Africa), on the continent (Africa) or international (Global) (for example Local and Global Property), as well as Unlisted or Listed. Alternative asset classes, including Hedge Funds, Private Equity, Managed Futures and sector/niche-specific funds, have also grown in popularity.

The asset classes and sub-asset classes all have different characteristics, different risks attached and different potential returns and each plays a particular role in a diversified investment portfolio. A fairly common categorization is to designate them as growth assets, defensive assets, income-generating assets and inflation-protection assets. Part of the portfolio construction process is an assessment of the appropriate risk-return profile for the underlying investor. The asset allocation within a portfolio is subsequently tailored to best fit the investors' needs – to reach the best combination of growth and defensive assets, income generation and inflation protection.



The first and perhaps best-known class of assets are equities. They are often called ***growth assets***. These assets are designed to grow capital. They have the potential to generate high returns, but also carry a higher level of risk and are more volatile, as illustrated by the picture above. International equities add diversity to the growth-asset bucket. Stock market returns across different countries are often uncorrelated, since they respond to different macro-economic and policy environments. The right mix of developed, South African and Emerging Market equities can ensure that your equity portfolio is well diversified.

Equities nonetheless are regarded as a relatively risky investment. So, to protect your portfolio, it is useful to add asset classes with different risk-return profiles. One such asset class is fixed interest. Fixed interest investments include bonds and debentures and are commonly referred to as ***defensive assets*.** Defensive assets carry lower risk but also typically generate lower returns than equities over the short term. Returns are largely uncorrelated with equities, so bonds may perform well when the equity portion of your portfolio is underperforming, but struggle when the stock market is booming. They also typically come with some form of regular income, usually in the form of coupon payments. Defensive assets, as the name implies, act as a buffer against market and policy shocks.

Cash is the asset with the lowest potential return. But it is also the least volatile asset class, and therefore highly defensive if you wish to protect capital. Another asset class which offers ***protection against inflation*** is Inflation-linked Bonds. Sitting somewhere in-between defensive and growth assets are ***income generating assets.*** These include investment grade corporate bonds and high yield bonds. They offer more room for growth in capital than traditional defensive assets (government bonds), but also carry higher risk (the risk is that the issuer defaults and the capital is not paid back).

Property is another asset class which has the properties of growth assets as well as income-generating assets. As property has the benefit of potentially increasing income, through rental increases, the asset class has potential risk, but equally has the potential for upside.

Some other assets fulfil multiple roles in your portfolio. Alternative investments like private equity and hedge funds can straddle the line between growth and income-generating assets, as we can see from the picture above. They can also fulfil a defensive and inflation-hedging role.

The different asset classes clearly have different characteristics in terms of risks, returns, time horizon and liquidity. They also tend to respond differently to market circumstances and macro- and micro-economic factors. An extremely important part of portfolio construction is ensuring that the portfolio is positioned to take advantage of growth opportunities but is sufficiently diversified and carries a buffer against inflation and market shocks.

The table below gives a brief summary of some of the characteristics of the major asset classes.

TYPE OF INVESTMENT	SOURCE OF INVESTMENT RETURN	RISK/RETURN AND LIQUIDITY
EQUITIES Securities that represent ownership in a company.	Returns come from increases or decreases in value, closely linked to company earnings and market movements Returns also come from income from the company's profits which are paid to shareholders as dividends Linked to economic, geopolitical and policy environment as well as to company-specific factors	Considered a high-risk investment But can potentially earn the highest return over the long term Traded on global stock exchanges, considered highly liquid and tradeable Value more likely to fluctuate in the short term. Longer-term investment
ALTERNATIVE INVESTMENTS Infrastructure, such as roads and airports. Private equity investments. Hedge funds	Returns come from increases or decreases in value. Returns also come from income.	Considered a medium-to-high risk investment. Potentially earn more than property, fixed interest and cash over the long term. Limited liquidity, due to fixed investment periods or conditions for withdrawal Value tends to fluctuate more than property, fixed interest and cash in the short term. Long-term, sophisticated investors
PROPERTY Industrial, retail or commercial real estate. Unlisted property funds. Listed property trusts. Direct property	Returns come from increases or decreases in value. Returns also come from income in the form of rent. Returns from listed property are linked to movements in the value of the securities and income generated by the property management companies.	Considered a more secure investment than equities and alternative investments Listed property trusts are considered highly liquid, as they trade on listed stock exchanges globally Unlisted property and direct property investments are notably

		less liquid, subject to fixed investment terms and conditions Generally associated with a regular and predictable income stream (rental payments) Potentially earn more than fixed interest and cash over the long term, but less than shares. Value tends to fluctuate more than fixed interest and cash but less than shares over time Long term investments
FIXED INTEREST Bonds Debentures	Returns come from interest paid on the loan amount (When buying fixed-interest securities, investors are 'loaning' money to a corporations or governments at an interest rate) Returns also come from increases or decreases in value of the underlying securities due to changing interest rates Closely linked to interest rate environment	Tend to provide better returns than cash over the long term, but lower returns than property and shares Fixed interest investments are easily traded in well-developed financial markets, and typically quite liquid. Within less developed financial markets, lacking depth and breadth and potentially lacking a secondary market, regular trade is limited. Medium-to-long term investment Value tends to fluctuate more than cash but less than shares.
CASH Money in bank deposits. Money in short-term money market securities.	Returns come from interest paid on the amount invested. Returns also come from increases or decreases in value of the underlying securities due to changing interest rates.	Generally a stable investment that provides steady returns. Over a short-term horizon, chances of losing money on cash investments are unlikely The most liquid of investable assets Short-term horizon Value tends to fluctuate due to changing interest rates. Returns tend to be lowest of all asset classes over time

		Short-term money market securities can increase or decrease in value over time, unlike money in bank deposits

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