CHASING PERFORMANCE

The stellar performance of the JSE over the last two years is creating understandable anxiety about a potential market crash. At the same time, it is also luring some investors into dangerous territory as they start to follow funds and shares that have already performed brilliantly in the hope that this performance will continue. As history has repeatedly taught us, chasing performance is a sure-fire way to lose money in the long-term.

THESE HAVE BEEN THE "GOOD TIMES"

The All Share Index has grown by more than 25% per year for the last two years and by 17% per year for the last five. In anyone's books this is a great return for equity investors and represents some of the best growth we have seen for a long time. This performance has created some major pitfalls that will catch unsuspecting investors so you need to exercise caution with your next investment decision.

DANGER: POTHOLES AHEAD

To illustrate these dangers, Resources unit trusts (those that invest in the mining sector) have averaged 4% growth for the year ending September. Over the same period, unit trusts investing in the Industrial sector have averaged 35% - a brilliant return. When investors start reviewing the most recent unit trust performance rankings, funds that have had a major exposure to mining houses will look very sickly compared to those that are invested in Industrial shares.

Investors will therefore be tempted to move out of funds with poor performance into those that have shown recent growth of 30% to 40%. Unfortunately, this is likely to be a bad investment decision. The valuations of the shares in the Industrial sector are way above their long-term fair value. As an example, Naspers and Remgro are more than double their long-term PE's. This is not sustainable and what goes up eventually comes down again. With shares, the correction is often brutal. So if you decide to invest new money into a fund that has just achieved a return of 35%, you need to be sure that you are not being overinvested in shares that are completely overvalued.

WHAT STRATEGY TO FOLLOW

If you are invested in a fund that has delivered a return of 20%, you might feel hard done by as the average equity unit trust has delivered a return of 22% over the last year. However, you need to understand how your fund is invested. You might be in a well-diversified portfolio with shares that are trading below their long-term value. If that is the case, a return of 20% is brilliant because your potential losses are limited and you might see great growth going forward.

Successful investing is about consistent returns – the more consistent your growth the better. Here is an example, if you had invested R100 into two funds for the last three years:

	Fund 1	Fund 2
Year 1	20%	35%
Year 2	15%	-20%
Year 3	10%	35%
Value of R100 after 3 years	R152	R146

Fund 1 has never achieved a return of more than 20% but it has also did not lose money. It is this consistency of returns that enabled Fund 1 to outperform Fund 2. Over the longer term, greater consistency will ensure even more outperformance. This does not mean you should invest all your money in a money market fund which delivers VERY consistent but poor returns. Rather aim for funds that have a long track record of delivering growth that comfortably exceeds inflation.