THE JSE CRASHES NEARLY EVERY YEAR

In 1999 the stock market increased in value by 71% but it still had a period where it actually lost 8% during the year. In every one of the last 15 years, the JSE has experienced periods where it lost money during the year. Share investors really should expect losses even in years when the market goes up. It is part of the normal market cycle and is certainly no cause for panic. It is important to establish the correct expectations about your potential growth from shares every year so that you do not receive any nasty surprises.

MANAGE YOUR EXPECTATIONS

Most experienced investors realise that it is a waste of time to predict what the stock market is going to do over a 12-month period. Many self-proclaimed investment gurus have tried and they all eventually lost money. If you are an investor in shares, you can safely make certain assumptions that will help you to understand the possible returns you can get from shares but you can never predict with any certainty, the returns you are going to get.

One of the best ways to get an indication of your expected future returns from shares is the current Price Earnings (P/E) of the market. If the current P/E is very high, you should expect your future returns to be low. As an example, at current P/E levels the market is likely to deliver an annual return of 13% per year but it could be as low as 3.6% per year. This is based on research by Nedgroup Investments as shown in the table below. If you are a novice share investor who has just started investing in shares expecting to get 20% per year for the next five years, you are probably going to be very disappointed. To me, this is the biggest mistake made by novice investors, they start with the wrong expectations. When the market does not meet those expectations, they sell their shares in disgust. Sadly, they usually sell just before the market recovers and delivers great returns.

	Average Starting P/E	Minimum P/E	Maximum P/E	5 Year Average Return (annualised)	Minimum Return	Maximum Return
Quintile 1	**5.8**	3.6	7.2	**32.6**	15.7	52.7
Quintile 2	**9.0**	7.3	10.2	**27.3**	13.9	42.2
Quintile 3	**11.7**	10.5	13.1	**20.7**	9.1	28.7
Quintile 4	**14.3**	13.2	15.5	**15.4**	6.7	26.9
Quintile 5	**18.6**	15.6	24.6	**13.0**	3.6	22.9

Souce: Thompson Reuters, Nedgroup Investments, data since 1974

The market will usually deliver fantastic returns (i.e. more than 20% per year) only when the current P/E is low, that means less than 11. That is the time you should expect to be handsomely rewarded. If you own share investments now, there is little point in selling them just because the returns are likely to be low, most other types of investments are likely to do worse.

MY PLAN FOR THE REMAINDER OF THE YEAR

Most investors are currently struggling to determine what to do with their investments at this time. The JSE is no longer cheap, the rand is so weak that it does not make sense to send money into offshore markets and interest rates are rising, which is bad for bonds and property. Personally I still prefer equities as I believe it is the most productive asset class for investors. I would however rely on a highly diversified portfolio of shares and will include some bonds, property and offshore assets. My reasoning for this approach is simple, in times of enormous uncertainty, relying on a diversified portfolio of high quality assets is probably your best protection. There is little point in sitting in cash for long periods of time as you will lose pace with inflation but I would certainly be phasing my money into these markets over a 6 to 12 month period.