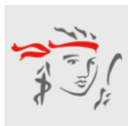
PRUDENTIAL **INSIGHTS**

PRUDENTIAL
INVESTMENT MANAGERS



Prudential Investment Managers
APRIL 2018

Making sure 'bad timing' doesn't get the better of your investments

Bad timing doesn't come more dramatic than the last scene of Romeo and Juliet, in which both protagonists take their own lives unnecessarily by incorrectly assuming that the other has died. Our lives may not be as theatrical as this but – whether it's puncturing a tyre on the way to your wedding or losing electricity while watching the World Cup final – we too can fall victim to bad timing that is entirely beyond our control.

Bad timing also relates to investing. But the good news is that in the financial arena at least, a little bit of restraint can go a long way towards staving off disaster. Let's examine three common ways that bad timing could throw a spanner in your financial works.

1. Selling underperforming investments for emergency expenses

As discussed in our previous articles, saving for emergencies is one of the absolute non-negotiables of financial planning. Although these investments are usually referred to as emergency funds, it's safer to think of them as funds for 'unwanted necessities'. Some of

the most common examples of these include medical bills which aren't funded by your medical aid, and unexpected car or home repairs that aren't covered by your insurance policy.

Most financial advisers recommend investing your emergency savings in safer cash investments with lower returns to help avoid the short-term ups and downs of the equity and listed property markets. However, it's easy to fall into the trap of wanting the best returns from your investments. This is a classic case of FOMO – Fear of Missing Out – which could drive you to invest in more volatile investments in search of higher potential gains. The danger of not having your emergency fund underpinned by solid cash investments is that you may be forced to sell at the bottom of a typical investment cycle, and in doing so realise a loss. Money market funds are well suited to emergencies as their value remains stable and generally increases with inflation if you reinvest the interest.

2. The tax man does not forgive bad timing

There are various types of tax that you, as an individual, may have to pay:

- Income tax in the form of Pay-As-You-Earn which is deducted from your salary
- Income tax on the interest earned on cash-based investments (but there is an exemption on local interest of R23,800 per year for those younger than 65 and R34,500 for those aged 65 and above)
- Dividends withholding tax (of 20% on local dividends) which is paid directly to SARS by the company issuing the dividend
- Income tax on business income such as consulting work, or rental income
- Capital gains tax on selling assets where the gain exceeds R40,000 per year
- Donations tax on amounts exceeding R100,000 per year (payable by the end of the following month in which the donation was made)

It’s not uncommon to overlook the last three types of tax on this list and consequently be forced to quickly sell volatile investments when the markets are low to cover your tax liability within the SARS deadline. If you sell and make a gain on an asset, for example, it’s a good idea to calculate how much tax will be payable on the gain and set that money aside for SARS - which never forgives bad timing and is consistent in applying penalties.

3. Bad market timing

Bad market timing by non-professional investors was brilliantly described by Rick Ferri in a June 2014 article in Forbes magazine:

“Successful market timing requires two correct decisions: when to get out and when to get back in. Guessing right once is a 50/50 proposition. Guessing right twice drops the odds to only 25 percent. One wrong guess and you shoot yourself in one foot; two wrong guesses and you shoot yourself in both feet. This is what makes market timing so difficult.”

Investors who try to time the market more often get it wrong than right and thus end up buying high and selling low. The market can recover fairly quickly after a dip, and if you get out when the bear sets in, it can become very difficult to get back in at the right time.

It’s all in the timing

We can’t control unfortunate timing in our personal lives, but we can usually prevent bad timing from affecting our finances too much. Whatever you do, take emergencies and your tax liabilities seriously by contributing to a cash-based investment such as the Prudential Money Market Fund for those ‘unwanted necessities’. Remember to leave the analysis of potential market movements to the investment professionals and don’t attempt to time the market.

Prudential’s wide range of funds includes money market investments for emergencies and tax liabilities and an array of longer-term investments geared for capital growth. To find out more about our funds, give us a call on 0860 105 775 or send us an email at query@prudential.co.za.