M&G Investments
June 2022

# Making sense of potentially confusing investment concepts

With so many different messages out there when it comes to investing, it's easy for the average person to feel overwhelmed and slightly confused. Fortunately, many of these concepts are actually a lot simpler than you might think. So to help you out, we've picked three of the more commonly misunderstood investment concepts that you're likely to come across and unpacked them in a way that's hopefully easy to understand.

## 1. Risk is 'bad' – or is it?

A common message that you might hear is that risk is 'bad' and can be detrimental to your portfolio. While in the same breath, risk is often described as being necessary if you want to achieve inflation-beating returns over the long term. This apparent contradiction can be baffling, particularly to novice investors.

Put simply, different assets come with different risk profiles. For example, equities (or shares) are considered the riskiest of all the asset classes due to the frequency at which their values can go up or down, and the extent to which these values fluctuate. In contrast, cash is considered the least risky of the asset classes in that it experiences the lowest amount of volatility; your money is generally "safe" unless something really drastic happens.

While putting your money at risk can be scary, it's important to have *some* equity exposure as part of a well-diversified long-term

investment portfolio. Your risk tolerance for equities is basically determined by the timeline of your investment goal: if you expect to need your capital in less than a year, you should probably avoid equities, while if you have a longer-term goal, some equity exposure is likely to be necessary. Depending on your changing risk tolerance, your exposure to risk may vary during your investment journey. But simply avoiding "riskier" assets like equities will most likely mean losing out on long-term growth in your portfolio, even if you do experience some volatility along the way.

# 2. Cash is safe – or is it?

When markets go through periods of volatility, many investors retreat to the relative "safety" of cash. Yet in reality, cash can be quite "risky" over long periods of time. The risk being referred to here is not the risk of losing money, but rather the opportunity cost of missing out on the returns on offer from other assets, such as equities, property or even bonds. This is because cash generally produces lower returns relative to other asset classes. Perhaps more importantly, cash investments can also underperform inflation, which means that your spending power gets eroded.

A common mistake that many investors make, for example, is having too much cash in their retirement portfolio, which can significantly reduce their potential returns. In fact, investors who do this could wind up being seriously short of capital and therefore unable to generate an appropriate income for themselves once they retire.

Cash has its place in a portfolio as it's useful for liquidity purposes; it just probably shouldn't be your long-term strategy for the bulk of your investments. Even as a short-term parking place for capital that you've earmarked for a particular purpose, you can often receive a better return compared to "cash in the bank" by investing in, say, an income unit trust, such as the M&G Income Fund.

# 3. Past performance predicts future performance – or does it?

Another common mistake that investors make is to look at the recent performance of an investment and assume that it will continue to perform that way into the future. However, in the absence of the proverbial "crystal ball", it is impossible to predict exactly how an investment is going to perform in the future. What can often happen is that a certain fund or type of investment can perform well in certain market conditions, but then as conditions change, that performance falls off. So one fund that was a top performer last year may not be "so tops" this year or next.

Instead, longer-term past performance can give you a good indication of how well fund managers are able to navigate across different market conditions, and how well they stick to their investment philosophy and process (and consequently, how well their investment philosophies and processes work).

The reality is that it is more a game of probability than absolute certainty. It's therefore important to choose a fund manager that has a sound long-term track record with a tried and tested investment philosophy, such as M&G Investments. Of course this doesn't guarantee future investment returns, but if the manager that you have chosen has a history of consistently achieving its objective, it's probable that it will continue doing so in the future.

While investing can be complex and potentially confusing, you shouldn't allow this to stop you from getting started. At M&G Investments, we've gone to great lengths to help make the world of investing accessible to all and easy to understand. Our Guide to Investing is a great way to introduce yourself to the basic principles of investing and key concepts that you'll need to know.

Working with a good independent financial adviser is another good option, especially if you lack the time or aptitude to tackle things yourself. Alternatively, for more information please feel free to contact our Client Services Team on 0860 105 775 or email us at info@mandg.co.za.