The Investment Odyssey

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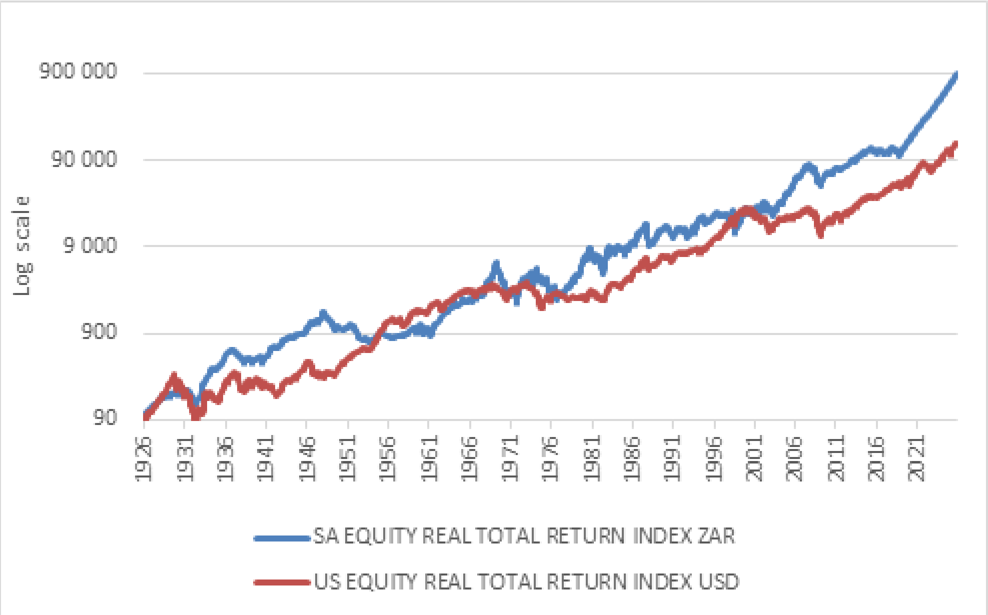
The Odyssey, director Christopher Nolan's big-budget retelling of the ancient epic poem, hit cinemas worldwide over the weekend. Dating back to the 8th or 7th centuries BCE, scholars debate whether it was written by a single author, Homer, or emerged as a collective work. There is no doubt, however, that it is one of the most influential works of the Western literary tradition. Among other things, it introduced complex nonlinear narrative structures, philosophical questions, metaphors, and the transformative journey as a core plotline. It tells the story of Odysseus, King of Ithica, and his 10-year long journey to return home from victory in the Trojan War.

Can we tell a similar epic tale of investing? To start with, it is also a long journey, with many ups and downs. Yes, there are people who trade markets minute by minute, but our focus is on building wealth over many years, even generations. The most potent tool we have to achieve this is the equity market.

Chart 1 shows how the South African market turned R100 of today's money into R229,000 while the US equity market turned $100 into $317,000 over the last 100 years by reinvesting the dividends. This is a period that included the Great Depression, a World War, the collapse of the British Empire, the rise and fall of the Berlin Wall, rapid technological change, and globalisation and the backlash against it. In South Africa, the last hundred years includes the rise and fall of apartheid, global isolation and reintegration, political uncertainty, and gold booms and busts. There were many hairy moments along the way. At no point did it feel inevitable that the market would continue rising, just as it doesn't today with a shifting geopolitical order, climate change, artificial intelligence and many other things to worry about.

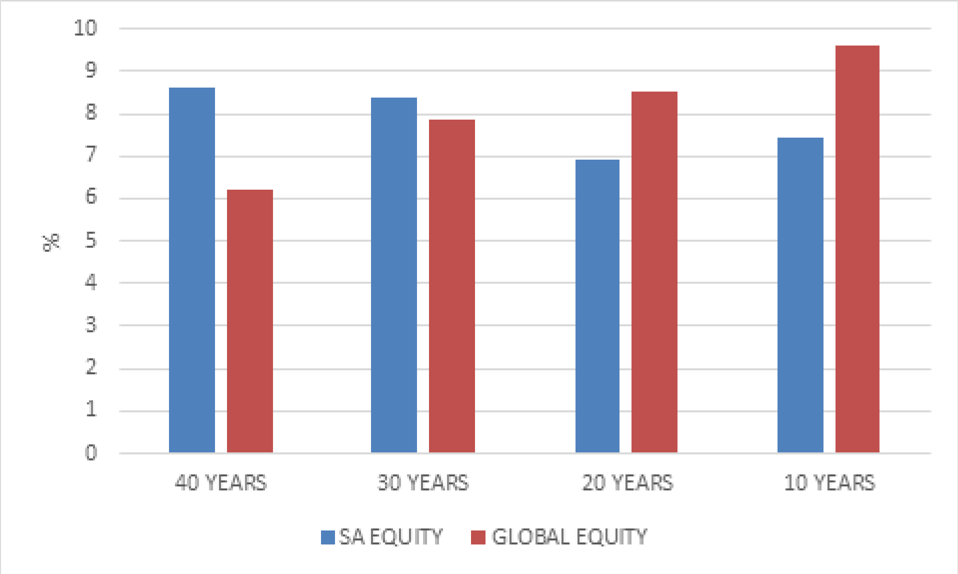
Chart 1: SA and US equities over 100 years



Source: LSEG Datastream, Iress, Robert Shiller

Chart 2 shows the annual return for shorter periods that align with most people's investment horizons, this time in rands and adjusted for South African inflation. The average returns from domestic and global equities differ somewhat over these periods, but both are solid, nonetheless. A 7.2% annual real return will double your capital every 10 years, even accounting for inflation.

Chart 2: Annualised real returns in rand over various periods to May 2026

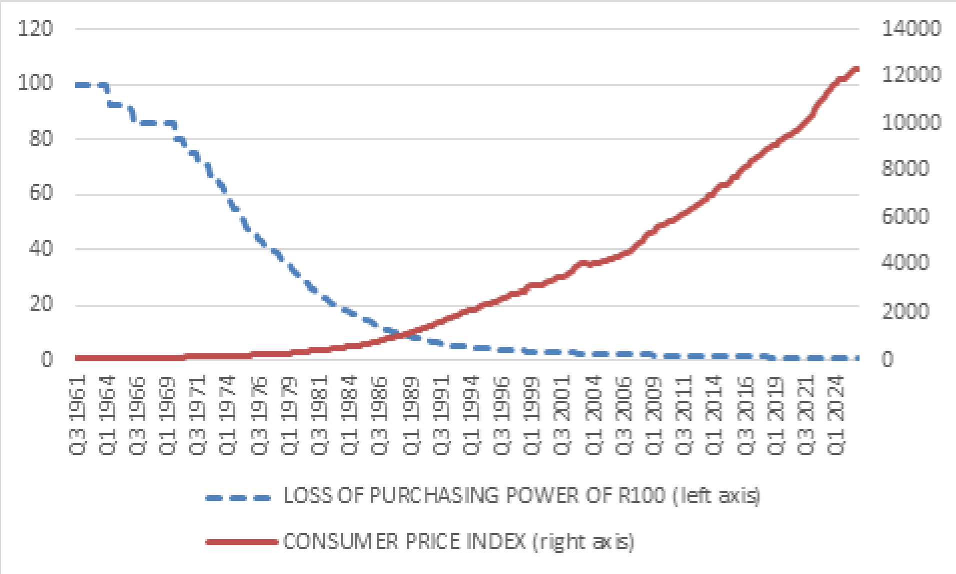


Source: LSEG Datastream

Silent but violent
Why adjust for inflation? Just as any great story needs bad guys, investors have foes. Sometimes, as we'll discuss below, they are their own worst enemies, but the great villain is inflation. As prices rise, the value and quality of the goods and services your money can buy decline. Ronald Reagan put it memorably, if a touch dramatically, when he said, "inflation is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man."

Chart 3 shows the South African consumer price index (solid line), which measures the cost of the average basket of goods and services of the average urban household over time. A basket that cost R100 in 1961 when the rand was introduced as a currency will cost R12,365 today, though of course its composition has changed a lot. The dotted line shows how the buying power of a fixed R100 income has declined. Today only gets you 0.8% of what you could get in 1961. Therefore, to grow your wealth over time, outpacing inflation is crucial.

Chart 3: The impact of inflation



Source: Stats SA

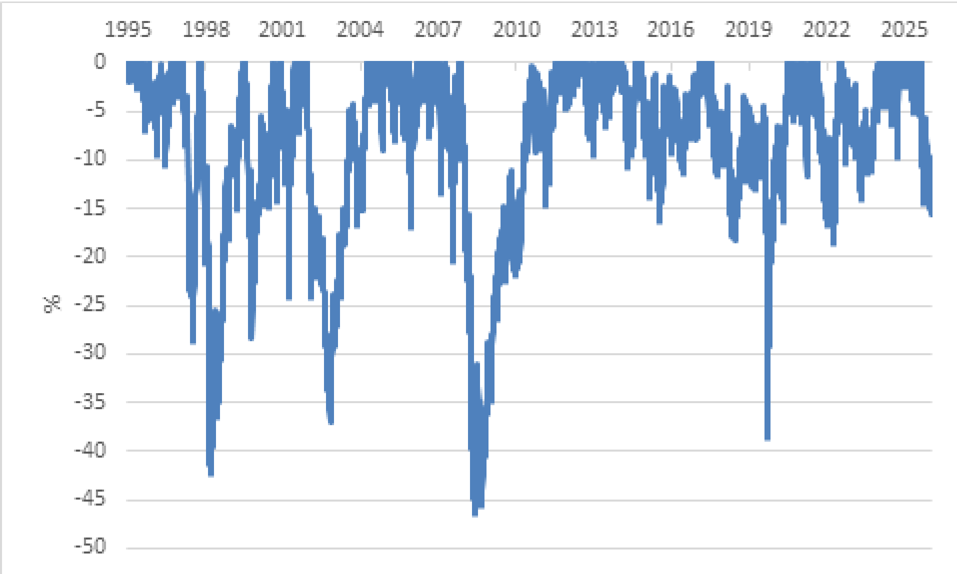
Simple, but not easy

Where do the riches shown in chart 1 come from? Not from the gods of Olympus, but from the magic of compound growth. Equity prices are driven by sentiment in the short term and can fluctuate wildly over days, weeks and months. But when we start talking about years and decades, equity prices rise because the profits of the underlying companies grow over time. This is partly because companies can capture the inflation that is so deadly to households' purchasing power – one person's spending is another's income – and partly because companies continuously look for innovative ways of growing their revenues and expanding their margins. A portion of the profits they generate are ploughed back into growing the business, and the rest is paid out as a dividend. Investors can use these to buy more shares that will pay more dividends, to buy more shares and so on. It's the eighth wonder of the world, as Albert Einstein may or may not have said.

If it was this easy, why doesn't everyone do it all the time? There are at two broad reasons. The first is that there are other more pressing or interesting things to spend money on. Many people don't earn enough to set anything aside once the basics are covered, but others prefer the instant gratification of a new car or holiday. Avoiding temptation is a recurring theme in the Odyssey, with the most famous episode being the song of Sirens, which was so beautiful that it inevitably lured men to their death. To sail past, Odysseus tells his crew to put wax in their ears and tie him against the mast. It worked. Investors face all kinds of modern Sirens, including tempting things to spend money on, but also alluring investments that promise easy riches. Bitcoin is a recent example. However, speculative behaviour is not confined to cryptocurrencies or tulips as was the case in the Netherlands in the 1600s. Mainstream equity markets have also seen bubbles, memorably the internet bubble of 1990s, and investors need to be careful of being sucked in by hype.

The second reason is that the volatility of the equity market scares many people off, especially during bear markets where peak-to-through declines are 20% or more. Even worse, many investors will get such a fright when the market starts falling that they sell out, thereby locking in what were paper losses. Chart 4 shows that though the drawdowns can be large, they don't last forever.

Chart 4: FTSE/JSE All Share Index peak-to-trough drawdowns



Source: LSEG Datastream

There is good news. These equity drawdowns present great buying opportunities. Yet human behaviour works against us. While malls get very crowded during sales events like Black Friday, people run the other way when markets go on sale. An easy way to get around this is to make regular purchases (like a monthly pension contribution) which ensure that you are buying even when the market falls, thereby getting more shares for each rand. This is known as rand cost averaging.

Now, you could look at charts 1 or 4 and say that the obvious solution is to sell before the market crashes. Although that looks easy in theory, it is almost impossible in practice. Markets sell off sharply from time to time when investors get a nasty surprise, usually in the form of reality not meeting expectations. Few of us are better at spotting these surprises than everybody else. What we can do is reduce exposure when the market looks expensive relative to underlying fundamentals, in other words, try to adjust our own expectations to a likely reality. This approach won't get the timing right but will help to avoid periods of excess.

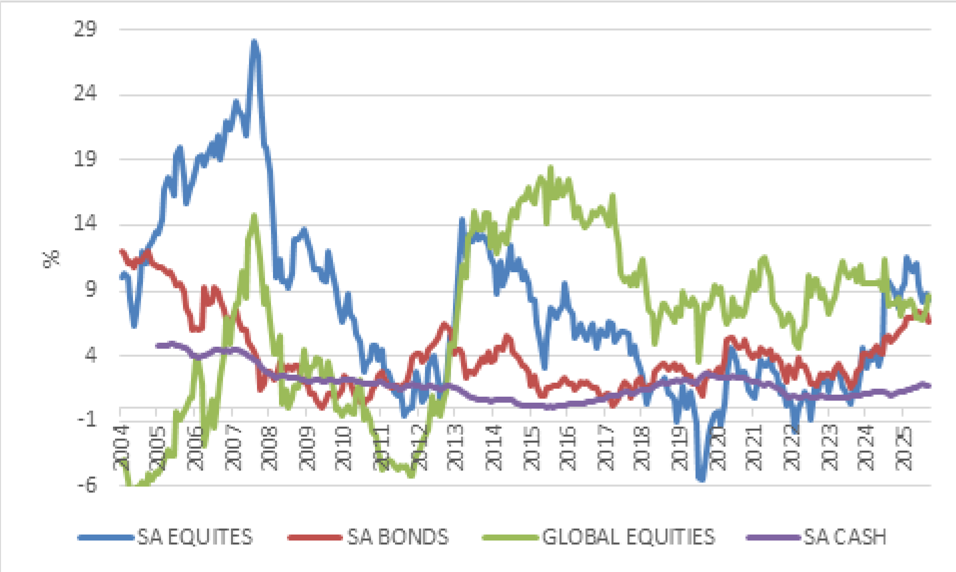
The other bit of good news is that the volatility of equities can be tempered. One option is hedging, which we won't go into here. A second is simply patience. If we could picture Odysseus in modern times, returning home and looking at his equity portfolio for the first time in 20 years (he spent 10 years fighting the Trojans before the arduous journey home), he would not see the day-to-day, week-to-week or month-to-month gyrations of the market. He would only see the growth over two decades.

Today, we can follow markets minute by minute on our phones, which is handy. However, there is something to be said for the days when portfolio statements arrived by post only once or twice a year. With constant information comes the temptation to do something, while doing nothing and remaining invested is usually the best approach.

Free lunch

A third way of smoothing the investment ride is through diversification. At any given point in time, different asset classes will behave differently, sometimes markedly so. Combining a range of assets can reduce the volatility of the portfolio without massively compromising overall returns. This was famously called “the only free lunch in investing” by Nobel prize-winning economist Harry Markowitz.

Chart 5 Rolling five-year real annualised returns in rand



Source: LSEG Datastream

Each point on Chart 5 shows the annualised real returns in rands over the past five years for the four main asset classes South African investors tend to buy. A few things stand out. Cash returns are steadier than the other asset classes, but do not always beat inflation and lag other asset classes over longer periods. It is a great portfolio stabiliser and parking bay while waiting for opportunities to emerge, but cash won’t create long-term wealth. Bond returns sit somewhere between cash and equities, generally beating inflation but also subject to volatility, though overall a useful source of diversification. Equity returns are cyclical and can dip into negative territory even over five-year periods. South African equities outperformed in the first half of the chart, while global equities led in the second half, the latter was partly driven by the rand depreciating sharply against the US dollar.

The value of diversification is even greater when we consider that the investing journey doesn’t stop at retirement, just as the story of Odysseus did not end when he is finally reunited with his beloved wife, Penelope, and son, Telemachus. The post-script is hinted at in another poem, The Telegony, which suggests that Odysseus did not have a quiet retirement.

Retirees invested in market-linked annuities are often caught between the Scylla and Charybdis of volatility and a lack of growth. The Ancient Greeks would be astounded how long the average person lives today. Retirees need to draw an income for 20 to 30 years on average, sometimes more. To beat inflation over such a long period, ongoing equity exposure is required. But equities come with volatility and the “sequence of returns” problem. In a nutshell, if the investor must constantly sell some of their shares to produce an income and the market falls sharply early on in retirement, the portfolio might never fully recover. The sequence of returns problem is effectively the opposite of rand cost averaging. Cushioning such a blow with an appropriate blend of asset classes is crucial, and this is where working with a financial adviser is particularly important.

In conclusion, we find ancient stories like The Odyssey compelling partly because they are so strange to us and our modern sensibilities. However, there is no denying that we can also see the similarities between ourselves and those characters and recognise our own flaws and follies. While Homer (or the co-authors collectively known as Homer) would be baffled by today's world, he would find the basic human psychology that drives our behaviour very familiar. It turns out that our emotions and cognitive blind spots, unchanging over the millennia, can be detrimental to our wealth. And while Odysseus only made it home with great bravery, guile and cunning (and a lot of violence), charting a course to financial freedom is straightforward: time in the markets (lots of it), not timing the markets.