MEDIA RELEASE

DECODING DIVERSIFICATION: THE KEY TO INVESTMENT SUCCESS

Many South Africans felt the effects of global economic uncertainty last year, and 2021 may prove to be similarly unstable. If you haven't already, this is the perfect time to learn about how investment diversification can boost your financial fitness and reduce your risk of injury in difficult times.

"Think of it as cross-training for your investments," says Michael Dodd, Head of Equity at Old Mutual Multi-Managers. Understanding risk, and, more importantly, how to manage it by using diversification, is the key to making sound investment decisions.

"It may seem like a scary, complicated topic, but it's actually very simple," says Dodd. "Your collection of assets and investments is referred to as your portfolio. When it comes to managing risk, the key is not 'putting all your eggs in one basket'.

The best way to manage your portfolio is to have diverse investments and assets – in other words, a broad range – spread along a spectrum of risk. For example, bonds, shares, property, and so on. Some of these will be less volatile (their value will grow steadily without many spikes or dips) but potentially low on rewards. Others may be more volatile, going up and down in value, but offer higher potential rewards over the long term.

"It can be helpful to think of your portfolio as a wardrobe. You have clothes for work, clothes for play, for gym, for sleeping. Each piece of clothing serves a different purpose. Likewise, when it comes to risk management of your portfolio, you want to have a variety of investments and assets for different purposes.

What's geography got to do with it?

Offshore investment is another form of diversification. "We call this geographic diversification," says Dodd. "The world is a big place. South Africa is only a fraction of the world's market, and by diversifying offshore, you can have exposure to companies in the US, the UK, Europe and other developed markets. You can grow your returns in emerging markets like China, or frontier markets across the rest of Africa."

Beware of 'diworsification'

The purpose of diversification is to reduce the overall risk in your portfolio. Sometimes, though, investors can diversify in a way that doesn’t improve the risk and return characteristics of their portfolio. "In the investment world, we sometimes call that ‘diworsification'” says Dodd because it actually worsens things.

“We often see investors who’ve put together too many funds that are all doing the same thing and not bringing anything different to the mix.”

Take your time

Time is the most important ingredient when it comes to investing. It can be tempting to pull your investment when a volatile stock dips in value, for example. But this is often not a good strategy, as patient investors who have a sound investment case behind those volatile stocks are generally rewarded with higher returns over the long term.

This is why it’s important to consult an experienced financial expert when making investment decisions. “With saving, you’re looking at more short-term goals, but with investing, you’re in it for the long haul, and that’s where serious financial fitness and wealth are generated,” says Dodd.

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