# Investment yarns result in high prices and lousy returns

According the author of the award-winning book *Homo Sapiens*, the success of humankind over other species came from the ability to work together and the secret to this togetherness came from the ability to tell stories that we could all collectively believe in.

We like stories, and this is nowhere more evident than in the world of investing. Unfortunately, when it comes to investing this story theory probably explains why the average investor sucks!

Good stories, which we like, result in high prices; the high prices then translate into lousy future returns.

Conversely bad stories, which we don't like, produce low prices, which counter-intuitively result in good future returns. Sounds simple, which it is, but not easy to do.

When the story is bad the average investor will not invest, preferring to allocate money to a good story and disregarding the most important driver of future returns – the price you pay. No matter how much empirical evidence the industry has gathered backing this up, investors are doomed to repeat the same mistakes of the past owing to their evolutionary wired behaviour.

The South African stock market is offering a perfect example. After five years of single-digit returns investors are so focused on all the bad news they are not just unwilling, but in truth, psychologically unable to invest in South Africa – notwithstanding the value on offer, which will translate into good returns over the next five years.

Rewind five years and the exact opposite was at play when investors were more than happy to commit money to the local market underpinned by a good story at the time.

To convince you to invest in South Africa, I am going to have to tell you a story. I have previously explained that equity market returns come from earnings and future growth in earnings.

Now we all know the local economy is in the doldrums, which explains the poor earnings and that growth is at best expected to be mediocre. So what will drive future returns?

Future returns will come from a re-rating in the market, as investor sentiment turns from despair to hope, then excitement and eventually euphoria, and the cycle will be complete. What will drive this re-rating is a 1% to 1,5% cut in interest rates post the election.

Our Reserve Bank governor was forced, as the only adult in the room, to have maintained a hawkish stance during the Zuma years to avoid being downgraded. This incidentally won him the award for best global reserve bank governor last year, as voted by his peers.

Post the election, with the reformers on the front foot, our Reserve Bank will be able to relax monetary policy, which is what the economy so desperately needs – and this will formally signal the bottom of the cycle.

Keep in mind: markets always look ahead and it is only possible when looking back to see when the cycle turned. I have a feeling we may already have bottomed, but only time will tell.

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**Money Matters**

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