Welcome to Vision 2018. It marks the start of our Research Team’s second decade of thought-provoking discussions of themes that are relevant to investors. Some are evergreen, some highly topical and others focused very much on the future.

This book is the first of a series of three – with further editions due in the Spring and the Autumn.
An interview with John Wyn-Evans

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Looking back at 2017 one of the key influences was politics. We had ongoing Brexit uncertainties, nuclear tensions in North Korea, elections in the Netherlands, France, Germany and UK, Donald Trump’s tweets, and so on. How significant has all this been given that markets have generally performed pretty well?

As we entered last year, investors recognised most of the major events to be mindful of, such as the Dutch and French elections. The one surprise was the UK election, as neither the election itself nor the result were expected. However, that had little effect on global market sentiment – like Brexit, to some degree, the election result was big news here but not for most of the rest of the world.

The rapid escalation in the war of words over North Korea was another surprise, but despite an initial impact on risk assets, financial markets have become much more sanguine about the threat of conflict on the Korean peninsula. The expectation is that common sense will prevail given that the alternative scenario is really too frightening to consider. We believe firmly that China, a primary actor in this drama, has absolutely no desire to escalate the situation as it has enough on its plate domestically in terms of managing the economy.
For UK investors, Brexit was a dominant theme in 2017. The headlines seem to paint a very bleak picture: a vision-less UK being bullied by a confident EU. What would be your assessment of Brexit and the prospects of the UK in 2018?

We would agree that the UK is a laggard. There are clear signs that Brexit is impacting the economy. Obviously, we have seen big falls in sterling and the subsequent impact on prices and the squeeze on real wages. There are also signs of a reduction in investment. There have been insufficient benefits to the export sector and manufacturers; there was some expectation that the fall in sterling would benefit them but the signs are that they are, in the main, increasing their margins and taking advantage of effective lower prices rather than building market share. Our key message on Brexit is that the UK’s terms of trade with Europe can be no better following negotiations, only the same or worse. Whether our trade with other countries will benefit is open for debate. The problem is we are planning to replace a trade partner on our doorstep with others who are potentially on the other side of the world. And it is recognised that ease of trade diminishes with distance.

At the moment, it seems likely that the UK will either pay a large sum to maintain trade benefits with the EU or face a hard divorce. Overall, we fully expect Brexit to carry on dominating the headlines in 2018 and to be a defining issue in the UK – if not in Europe itself or globally. As such, having a global perspective will remain key.

Will political risk continue into 2018? Are there any particular events coming up that are already flashing on your radar?

Politics will continue to create headlines, but the market impact will remain limited as long as economic momentum is maintained. The US, after a wobbly start to 2017, has stabilised. Europe has definitely accelerated. China, in the run up to the party congress, was stronger than expected. And Emerging Markets have generally done well too, owing to a recovery in global trade.

It is important to point out that one of the negatives from 2015/16 was the falling oil price which bit enormously into capital expenditure, particularly in the US. The impact on the global economy was profound. But that has now worked through the system, investment is picking up and the ‘bounce back’ is noticeable.

One of the key elections we know will happen in 2018 is the general election in Italy, but here the anti-EU narrative has weakened, while Italian growth has picked up. Italy’s economy grew by an annualised 1.8% in the third quarter. It is possible we will have another German election but again we do not expect that will be hugely disruptive as Germany is coming from a position of strength. An election in the UK is also possible, but, looking at it from a global perspective, this is a localised risk. US mid-term elections could see some losses for the Republicans, so Trump needs to make some headway with his policies.
Sentiment towards Europe seems very positive, notwithstanding recent political risk in Germany and the forthcoming Italian general election in May 2018. How solid do you think the ‘European project’ is as we go into 2018?

There has been a lot of focus on Europe in terms of both economics and politics, and this has been reflected in positive investment sentiment and investment inflows. Germany is a long way ahead of the pack in terms of other EU economies but Europe as a whole is exhibiting signs of more stable, sustainable growth. It has entered an economic ‘virtuous circle’, whereby growth supports investment and employment growth which in turn brings credit growth – and these reinforce each other.

Europe is benefitting from positive investor sentiment, and that can continue given the lagged recovery. Europe took much longer to take its medicine in the wake of the financial crisis than, say, the US or UK, and so the benefits are coming through later, but also at a time when the global economy has positive momentum.

It is true that Europe could be affected by an ‘unknown’ external shock in global demand impacting the continent’s recovery, which has the potential to reignite concerns about the European project and the euro, but the continent is at least in a much better position to deal with such a threat now.

What is sentiment like regarding UK assets and the UK economy in 2018?

The two should be seen separately. Many UK assets remain attractive. Multi-national companies listed in London offer a natural hedge against domestic difficulties. The wider UK economy, however, is not as robust, and we have seen this reflected in house prices and retail sales. The Government, in its latest budget, has at least loosened fiscal policy, which provides some relief, but a plan to build 300,000 houses per year feels optimistic, given skills shortages in the industry.

In November, the Bank of England (BoE) raised the base rate to 0.5% – the first rise in ten years. What is the expectation for further rate raises in 2018? Given the rate rise, can we say that the UK is finally off life support?

The rate rise doesn’t necessarily mean the UK is in better shape. The Bank increased at a time when the economy is decelerating, which is not optimal. To some extent, having guided markets to expect a rise, it had to follow through to retain its credibility. Governor Carney was becoming known as the “unreliable boyfriend” for not sticking to his guidance. The BoE cut rates by an emergency 0.25% in the aftermath of the Brexit vote and it could be argued that it has simply reversed that decision. More positively, the move serves as a reminder that rates can go up as well as down, which might deter people from becoming too indebted.

We would be cautious about future rate rises given the wider economic weakness in the UK and as the Brexit negotiations continue to unfold. In this context, further monetary tightening may be unnecessary.
China’s ‘soft’ power globally became a little harder in 2017 while tensions around both North Korea and the building of islands in the South China Sea continue to top global concerns. That being said, 2017 also saw China take further steps to open up its market to foreign investors. How should we view China?

We see China as a key opportunity, not a threat. While there are concerns around human rights, corporate accountability and so on, the country has benefitted from a rise in personal wealth and a strong economic ethos. We are seeing the Chinese becoming more socially mobile, as evidenced by growing numbers of outbound Chinese tourists. The country’s tech sector is evolving rapidly, as evidenced by its huge on-line retail market and investments in electric vehicles, for example. China itself sees this as a normalisation of its historical status – it was the world’s largest economy for much of the past thousand years, even up to as recently as the 18th century, and there is clearly a strong sense internally of a confident, bullish nation looking to expand and increase its presence overseas.

Debt levels in China are high and the government is trying to damp down more speculative activities. However, that doesn’t guarantee a crisis. The key point about China is that it is almost entirely self-funded and the risks are therefore limited.

How do you view other key markets – the US, China, Japan, as well as Emerging Markets. Which stand out for you in terms of strong fundamentals?

There is much better economic and corporate momentum outside the UK. Reflecting this sentiment, Investec Wealth & Investment is overweight Emerging Markets, Europe and Japan as we head into 2018. There are some notable industrial and sector shifts taking place which investors need to be aware of. For instance, technology has become a core driver of growth. Some 22% of the US stock market is now attributable to the tech sector against just 1% in the UK. So, if you want to invest in technology you need to look further afield. The US is the tech leader now, but China aspires to that position, and also benefits from a growing middle class, a trend that is reflected throughout much of Asia. To invest in technology you need to look further afield. The US is the tech leader now, but China aspires to that position...
What will be the key themes you will be discussing with attendees at the forthcoming Vision 2018 Roadshow?

There’s a lot to talk about! The key focus will be on the significant opportunities open to investors on a global basis, and the benefits that Investec Wealth & Investment can bring. Yes, the UK may be in the doldrums but markets generally have good momentum with, for now at least, little to suggest a major correction is due. We have come a long way since 2008/2009 with real progress made in terms of repairing the financial system.

Having said that, another point we will make is that investors need to recognise that markets do fall. It may sound hackneyed but it is important to look beyond these events and focus on the long term. Emphasising the long-term nature of investing is a central tenet of our Vision Roadshows. It always has been and always will be.

Where do you see the investment opportunities in 2018? How are you positioning portfolios as we go into the new year?

Different countries are at different stages of the economic cycle. Going into 2018, we are underweight the US and UK and overweight Europe, Japan and Emerging Markets.

We do not envisage strong returns from fixed income assets. The role of government bonds is more as insurance against unexpected negative economic developments. There are some attractions to Emerging Market debt but we have taken profits in High Yield and see better opportunities elsewhere.

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“Absolutely nothing!” sang Edwin Starr although it is doubtful that he was much interested in investment markets, otherwise he might have had to change the words. The makers of armaments, for example, tend to benefit handsomely.

“War... What is it good for? Absolutely nothing!” sang Edwin Starr in 1970. From an existential perspective, and given that he and the song’s composers were railing against the Vietnam War, he might have had a point.
In that context, we are talking about what might be described as a “hot war”, a prospect that rose alarmingly during 2017 as North Korea appeared to be close to developing a nuclear capability and became increasingly aggressive in its stance towards the United States. However, there were already a number of more subtle wars being waged that were influencing economies and the behaviour of investors. No actual missiles are being fired in these wars, but they still have the power to disrupt.

One of the biggest market influences recently has been the rise of populist politicians, signalling a form of Class War, a subject we discussed last year (see Vision 2017 – Angry Politics). Since then the Labour Party in the UK has also gathered strong momentum and its left-leaning leadership threatens a return to the sort of redistributive policies that would be painful for investors – think higher taxes on capital gains, unearned income, and even, potentially, capital itself.

Mr Trump’s arrival in the White House has been altogether more confusing. Investors initially reacted to his victory by bidding up the shares of more economically sensitive companies in anticipation of policies that would stimulate growth, but became more equivocal as little progress was made. It is one thing to make promises to voters, quite another to deliver on them.

In 2017 we also saw much uncertainty ahead of several major elections in Europe, notably in the Netherlands, France and Germany. In all of these countries, the fear of sweeping gains, possibly even outright victory, by far right parties held many investors back from taking advantage of the underlying recovery in the local economies. Those that were able to anticipate the correct results benefitted from others’ indecision. Thus we see that political influences can offer opportunities to those who are willing to take a view and a modicum of risk.
The entry of China into the World Trade Organisation in 2001 was a key moment.

Allied to the theme of electoral cycles are Trade Wars. Again, these do not involve flying bullets, but have the capacity to disrupt growth. The downside of global trade is captured in the grievances expressed in populist politics, but the benefits have been manifold. Consumers have a greater choice of goods, the quality of which has generally improved while prices have been restrained as manufacturing has migrated to lower wage regions. The entry of China into the World Trade Organisation in 2001 was a key moment. Now, however, the backlash has begun. Mr Trump has already pulled out of the Trans-Pacific Partnership and seems keen to withdraw from (or at least to renegotiate) the North American Free Trade Agreement, all in the hope of restoring manufacturing jobs to the US.

In one very specific case, the US has imposed tariffs of over 200% on Bombardier’s new C-Series aircraft, citing illegal state support by Canada and the UK (the plane’s wings are made in Belfast). Unsurprisingly, this would favour US aircraft manufacturer Boeing.

Closer to home, the Brexit negotiations encompass the UK’s future trading relationship with Europe. It is impossible to envisage how any future agreement can be better than what exists, as we are now part of a tariff and customs-free zone. Scare stories of queues of lorries snaking back miles from the ports of Dover and Calais might be too alarmist, but even the need for a signature on just one extra form constitutes a new grain of sand in what is at present a smoothly functioning system. The upshot for consumers is less choice, more delays and potentially higher prices.

“In war – what is it good for?”
It is still far from clear whether or not Russian hackers managed to influence the outcome of the 2016 US presidential election, and in many ways it suits the Russians if the answer never becomes clear – after all, the element of uncertainty introduced by such tactics is part of their threat. But the idea that supposedly free elections in democratic countries can be influenced by agents with competing ideologies is disturbing to say the least. More visible harm comes in the form of, for example, Distributed Denial-of-Service (DDoS) attacks. These involve overloading individual networks or websites with automatically generated e-mails or requests, thus making them unavailable to customers. This style of attack can be used to shut down individual companies’ websites and internal networks or to prevent the dissemination of information. There have also been allegations of the theft of intellectual property, as countries attempt to gain the upper hand in the technological arms race. Cyber warfare represents a growing threat, with power grids or air traffic control systems, for example, deemed to be prime targets in terms of public utilities. The cost of putting up defences against such attacks will be borne by all of us.

A key perpetrator of computer-based attacks is, allegedly, North Korea, and it is this country that currently also represents the greatest threat of a “hot war”. Kim Jong-un has been aggressively demonstrating his long-range ballistic missile capabilities, while at the same time developing nuclear warheads, meaning that the threat of outright nuclear conflict is greater than at any time since the Cold War. And yet markets have barely flinched. Investors – including us – have taken the view that the main actors will remain rational and that the concept of Mutually Assured Destruction will prevent any of the parties involved from being the first to strike.
start of a strong rally. Equity markets today certainly do not seem to be in any position to enjoy a “relief rally”.

The last war to consider is the War on Terrorism. This has been waged in earnest since the Twin Towers attack in 2001, but has proven a difficult one to conduct – after all, how do you wage a war against an ideology whose adherents have scant regard for their own lives? Moreover, it is not confined to any particular territory, and certainly fails to adhere to the guidelines of the Geneva Convention, because civilians tend to be first in the line of fire. So far, the effects appear to have been limited, although certain companies have reported a drop in activity following incidents. One fears that either another highly disruptive act will have a more deleterious effect on markets, or a steady drip of them will slowly erode confidence.

We can only hope that this remains the case. Nuclear conflict, in the current era of global commerce and supply chains when investors roam a long way from their home markets in search of returns, would represent an enormous threat to economic activity and wealth preservation. Nothing negative is currently being anticipated. Equity markets remain at all-time highs at the time of writing. The S&P 500 Index lost around a third of its value between the outbreak of World War II and its nadir in April 1942, before doubling by the end of 1945 (the US entered the war in November 1942). Similarly the index halved in the three years preceding the invasion of Iraq in 2003 (although much of that was down to the bursting of the Tech bubble and the effects of the terrorist attack on the World Trade Center). The outbreak of hostilities was the cue for the

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For the last three decades the world has benefitted from what became known as the Peace Dividend. The end of the Cold War ushered in a period of relative calm and the fall of the Berlin Wall signified the triumph of western liberal capitalism over centrally directed economic models. Globalisation was on the rise, and inflation on the wane. There was never a better time to be an investor. While it is not clear that all of these positive drivers are going into reverse, they do all seem at least to be running into headwinds. This would suggest lower growth ahead, and potentially a tendency towards higher inflation (although this might be counteracted by ageing populations and the advances of technology). Certainly in the US the evidence suggests that major hostilities are accompanied by periods of rising inflation as resources are diverted towards the war effort.

After years of disinflationary trends, at times creating the risk of outright deflation, a shift to a more inflationary environment would constitute a major potential threat to the real wealth of investors and demand changes to the composition of portfolios, especially when seeking more defensive assets. We are continually monitoring the risks and will implement those changes accordingly.
Recent images of the floods in Texas and Florida in the aftermath of Hurricanes Harvey and Irma do not suggest any shortage of water. This sits in direct contrast to the dystopian vision highlighted by David Barker in his recent book Blue Gold, which portrays a future in which terrorists and governments vie to commandeer the shrinking resources of water.

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“Water, water, every where, nor any drop to drink”

Coleridge’s famous lines from the Rime of the Ancient Mariner ring very true today, despite being written back in 1798.

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“Water, water, every where, nor any drop to drink”
First, we look at demand and explain how it is divided (in the main) between agriculture, industry and domestic applications; second, we examine the resource itself, which is of course finite, and discuss how it can be recycled; third, we look at technology and its impact on both usage and purification in the replenishment phase; finally we consider how pricing policies might be implemented in future, both for users of the resource and those who might be responsible for the cost of its recycling.

Could a war be fought for the control of water? Perhaps that seems far-fetched, yet many people in the developed world take access to water for granted; meanwhile the geographic imbalances between where potable water is available and where it is needed have never been greater.

In this article, we examine the long term trends in water consumption, fuelled by strong population growth as well as the trend towards urbanisation to which we drew attention in an earlier edition of Vision, and consider how the world will manage its response to such demand increases.
Population growth, urbanisation and dietary change are magnifying such trends. Additionally, in a world where growing economic inequality is driving international conflict, the idea that water is becoming such a valuable (and limited) resource to prompt both governments and terrorists to seek to control its supply is not implausible. As is shown by the maps, large tracts of the continents are predicted to move from small shortages of water to much more significant shortfalls in less than a generation.

To illustrate the imbalance between “supply” and “demand”, consider the following: North America has about 30% of the world’s supply of freshwater, but represents only 5% of the global population; by contrast Africa and Asia account for 76% of the world’s population, but have a mere 42% of the global resource. Water scarcity is one of the most important issues facing the world and the gap between availability and demand, at a global level, at a country level and within individual countries (especially the larger ones such as the US) is getting bigger. A report prepared for the World Economic Forum in Davos in 2012 concluded that the livelihood of as much as one-third of the world’s population would be affected seriously by water scarcity within 20 years. In that time frame the supply shortfall could, without change to the current paths of supply and demand, be as much as 35%.

Demand for water continues to grow; according to the Organisation for Economic Co-operation and Development (OECD) global consumption will increase by around 55% over the next 35 years, of which about half is accounted for by population growth and the remainder by rising usage per capita, driven by long-term secular trends such as greater urbanisation, more use in energy production and changes in diet.
Consumption per head varies widely between countries in the developed world and those in Africa and Asia; the composition of that consumption by sector (domestic, commercial/industrial and agricultural usage) is also very disparate as can be seen in the accompanying chart. More than half Europe’s water usage is in industry, especially in areas such as power generation, whereas in Africa industrial users account for only 7%. Changes to eating habits should not be underestimated as a driver of additional demand for water: each kilo of beef consumed requires more than five times as much water to produce it as the equivalent weight of vegetables or pulses, according to a recently commissioned study for UNESCO.

Given that water is a finite resource, what happens to it after use is extremely important, both in terms of who pays for the treatment to restore it to a standard for human use and in terms of its re-availability. Wastewater treatment varies dramatically, with more than 70% of it being treated in advanced countries, but only 8% across the emerging world. Whilst water treatment simply returns treated wastewater to the water table, water reuse takes the process one step further; it takes effluent from industrial and municipal sources and treats it to a standard of purification that enables reuse at least in agriculture and industry. Those parts of the world which have less plentiful water, but do have money and/or access to technology, are in the vanguard of this particular trend – Australia for example reuses 20% of its wastewater whereas the US reuses less than 4%.

“Water, water, every where, nor any drop to drink”
Other than reuse, an alternative route to improving availability through technology might be desalination: this refers to a range of technical procedures and processes to remove salt from water and is most widely practised in the Middle East (which – together with North Africa – represents almost half of global capacity). Although some of this technology has been around for more than half a century, the scale of desalination capacity has blossomed in the past quarter-century, multiplying by more than four times in this period.

There are now over 18,000 plants around the world, which collectively produce 1% of the world’s drinking water; it does come at a cost however, in that desalination is power-hungry, so that these plants use over 0.4% of global electricity consumption in the process.

Expenditure on industrial water treatment and recycling is expected to grow by close to 50% over the next five years. More broadly a recent study by McKinsey estimated that the world’s annual investment to deliver sustainable water and sanitation services should average $500bn annually until 2030.

This encompasses a broad span of requirements such as meeting World Health Organisation guidelines on drinking water, extending access to water and sanitation services across a greater proportion of the global population and improving wastewater treatment as well as innovative technology such as smart metering and real-time data monitoring.

As can be seen from the chart opposite, the OECD estimates that countries, especially those in the emerging world, will need to increase their expenditure on water infrastructure over the period 2015-2025. Only in the US of the countries shown in the chart does the OECD believe that an increase will not be necessary; in Brazil, by contrast, the proportion of GDP earmarked for water infrastructure is predicted to rise almost tenfold. Although Brazil has almost 12% of the world’s freshwater resources, its distribution throughout the country is remarkably uneven and the modern aspects of sewage treatment and full access to water will require substantial capital investment. Similarly the South-to-North Water Diversion Project (China’s principal civil engineering scheme) is estimated to cost as much as $60bn during its construction over the next 30 years. Rather more modestly the UK’s £4.5bn project to drive a new 16 mile super sewer beneath London will be the first major overhaul to Joseph Bazalgette’s original designs of around 1860 – since when the population of London has more than doubled.

...desalination is power-hungry...

“Water, water, every where, nor any drop to drink”
The construction will take seven years, finishing in 2023, and the main tunnel of 24ft diameter should enable overflow discharges of raw sewage into the Thames to be reduced by as much as 90%.

Many would argue that access to water is an inalienable right given its essential nature to life and should not be regarded as something to be bought like any other consumer item. However users can easily become wasteful if a commodity is free. Unlike other utility costs such as electricity, gas and telephony, consumers historically have rarely considered their water consumption and taken delivery for granted.

That is changing; water meters have been installed automatically in the UK in all houses built since 1990 and adoption, including houses where meters have been fitted retrospectively, has now reached just over 50% of all households. It is materially higher than that in the South of England but much less in other parts of the country. Internationally, and especially in the developing world, water meter adoption is expected to grow at a more rapid rate, potentially around 5% annually for at least the next five years.

There are many implications for investors amongst these themes; the water resource challenge is emerging as a very real economic issue for governments of many developing countries and, if not tackled, could inhibit forecast GDP growth from being delivered. Thus investors attracted by the allure of rapid economic and corporate growth across Emerging Markets might be disappointed.

By contrast, within the huge amount of both infrastructure spending and technology applications designed to deliver more flexible and resilient water systems around the world, there should be opportunities for investors to benefit accordingly.
The market sometimes over-rewards for low risk and fails to compensate for risk-taking. The reason for this – and the main drawback of modern portfolio theory – is that it fails to capture human behaviour, emotions and the psychological impact of financial decision-making.

Modern portfolio theory is built upon the belief that all investors act rationally in ways that maximise returns for taking a given level of risk.

The patient investor
There are broadly two types of behavioural biases – cognitive and emotional – with emotional biases being more difficult to overcome.

Cognitive can then be split into behavioural perseverance and information processing, which can be expanded into 13 behaviour traits. Plenty of academic papers suggest there are around 20 categories of behavioural bias that disrupt the efficiency of the capital markets. We will focus on a handful of them that individual investors suffer from most, regardless of the level of assets under management. Our objective is to explain what biases humans possess, how they affect financial markets and how they can be overcome to make more rational decisions.

Participants in the financial markets, from pension funds, university endowments and institutional asset managers to individual investors, all exhibit various types of bias and so collectively distort the capital markets. Eliminating biases is a tough mission but being aware of them can help us to manage them better.
People who have a lot of wealth have a tendency to be confident in their own abilities and judgement. Whilst that conviction can benefit them in taking risks, an overconfidence in their abilities can impair their decision making. Research has documented that overconfident behaviour leads to excessive trading, which actually results in poor investment returns (Ricciardi, 2008). It can also lead to investors being too limited in their investments and not having an appropriate level of diversification. Another finding backed up by research by Barber and Odean (2001) is the role of gender bias in a sample of 35,000 individual accounts. Their findings revealed that male investors were more prone to overconfidence and to trade more frequently than their female counterparts. This meant that men incurred higher trading costs than women, who generally applied a "buy and hold" approach. To overcome this bias, investors need to resist attributing short-term successes to superior knowledge, ability or skill. Individuals should be investing for the long term rather than trading for the short term.

The polar opposite to overconfidence bias is timidity which tends to engender conservatism. Rather than trading too frequently, investors that are overly conservative fail to incorporate new information or tend to default to the same judgement or accept the current situation. Those exhibiting these biases tend to trade too little. Research has revealed the drawback of an overly simplistic "buy-and-hold" strategy for long-term investors as people exhibit severe inertia or inattention. Changing this inertia requires strong motivation or incentive. To overcome this bias, investors should implement a disciplined investment strategy, for example matching their level of risk tolerance to a predetermined asset allocation. Those unable to break out of their inertia can outsource the rebalancing decision to an external fund manager. Another way to overcome this inertia is to rebalance the portfolio at least annually to ensure that the asset allocation matches the investor's risk tolerance profile throughout the life of the long-term portfolio. Some investors make decisions based on how easily information is presented to them. Those who exhibit this behavioural bias will put more emphasis on recent news than historic data and on predicting an outcome based on how easily it comes to mind. This results in investors preferring familiar investments despite the seemingly obvious benefits of diversification.

1) The Psychology of Risk: The Behavioural Finance Perspective (Victor Ricciardi, July 2008) 2) Boys will be Boys: Gender, Overconfidence and Common Stock Investment (Brad M. Barber and Terrance Odean, February 2001)
To overcome home bias, investors need to expand their portfolio allocation decisions to include international securities to gain wider diversification.

...is this bad news phrased in a positive light in order to lead us to reach a positive conclusion? For this reason a number of institutional fund managers swear by not meeting company managements and take the view that corporate speech is manipulated and professionally framed to try and influence us favourably. A research study has shown how doctors can actually change their patients’ minds about a surgical procedure based on how they frame their message. Patient decisions were much different when the doctor said “you have a 90% chance of survival” versus “you have a 10% chance of dying.” Despite the odds being exactly the same, more patients opted for surgery when it was framed in terms of survival. Financial news and economic data are especially prone to framing bias when reporters compare them to either the peaks or troughs, and perception maybe distorted quite easily.
People often base their decisions on the first source of information to which they are exposed (for example, an initial purchase price) and have difficulty adjusting their views to new information. Research by Ricciardi (2012) suggests that many investors still anchor on the financial crisis of 2007–2008 as a bad experience, resulting in a higher degree of worry that can cause them to be underweight equities. To combat this, investors should consider a diversified range of investments and adjust their views to new information.

Some investors divide their total wealth into layers depending on their utility. One common way in which money is divided is into a safe investment portfolio and a speculative portfolio. This is often done to separate the risk taking in the speculative portfolio from the safer portfolio that could be used for retirement or for a house. Whilst people who apply this technique believe it is a disciplined process, the investor’s total wealth has not changed and separating the investible capital into various pots reduces the benefit of diversification. Even seasoned investors are susceptible to this bias when they view recent gains as disposable that can be used in higher risk investments. To overcome this, it is best to understand the bigger picture, considering the overall investment objective and risk tolerance before reaching an investment decision.

Some investors are afraid to act because of regrets associated with past mistakes. This behavioural bias leads to conservative investing, investing in familiar securities and over-concentration. To combat this, investors should update their views with new information, look for more ways to diversify and consistently re-assess the investment thesis.

Similar to regret aversion is loss aversion, the tendency to hold onto losing investments in order to avoid crystallising losses. This behaviour derives from our human survival instincts, responding more to losses than the same magnitude of gains.

Research has demonstrated that on average people require the potential gain to be at least double the potential loss in order to proceed with an equal chance bet (Kahneman & Tversky, 1979). The investment consequence of this is owning only assets that are perceived as “safe”, selling winners early and holding on to losers for too long, and ultimately excessive trading.

Dismissing or ignoring these behavioural biases can be detrimental to investment returns. Investors can eliminate the emotional part of investment management by letting investment professionals, with their disciplined investment processes, wrestle with it.

4) Prospect Theory: An Analysis of Decision under Risk (Daniel Kahneman and Amos Tversky, March 1979)
than the sum invested. Higher volatility investments are subject to sudden and large falls in value and could result in a loss equal to the sum invested. Certain investments are not readily realisable and investors may experience difficulty in realising the investment or in obtaining reliable information on the value or associated risks. For securities denominated in a currency other than sterling, changes in exchange rates may have an adverse effect on the value of the investment or on the income thereon. The stated price of any securities mentioned herein is at the end of the business day immediately prior to the publication date on this document unless otherwise stated and is not a representation that any transaction can be effected at that price. No personal recommendation is being made to you; the securities referred to may not be suitable for you and this material should not be relied upon in substitution for the exercise of independent judgement or seeking independent advice. Investec Wealth & Investment will not be liable for any direct or indirect damages, including lost profits, arising in any way from the information contained in this material. This material is for the use of intended recipients only and is not directed at you if Investec Wealth & Investment is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. This document is being supplied to you solely for your information and may not be re-produced, re-distributed or passed to any other person or published in whole or in part for any purpose. The material in this document is not intended for distribution or use outside of the United Kingdom.