OCTOBER

2021

FINANCIAL INSIGHTS

by

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UNDERSTANDING PORTFOLIO DIVERSIFICATION

If you're just getting started with investing – or if you're researching how to get the most out of your investments – then there's no doubt you'll have come across the term 'diversification' when it comes to building an investment portfolio.

WHAT IS PORTFOLIO DIVERSIFICATION?

In the investing world, portfolio diversification invests in assets across different asset classes, in different companies, sectors, and industries and across different countries to mitigate risk and limit the impact of a poorly performing investment.

As a result, an investor's 'portfolio' should compromise in various investments. These should be diverse and wide-ranging – though it's important to note that a diversified investment portfolio doesn't have to cover every industry or sector – and the positive returns form part of the investment portfolio should counteract the poorly performing investments.

HOW CAN INVESTORS CREATE A DIVERSE PORTFOLIO?

According to mathematical modelling research, a diversified portfolio of 25-30 stocks and equivalent investments provides the most rewarding, low-risk investment method. However, a diversified portfolio can be created with fewer stocks.

Investors should choose several different types of investments to build their investment portfolio, such as:

- Stocks – shares or equity in a company
- Bonds – government/corporate issued securities that allow investors to invest in debt.
- Funds such as…
- Index funds, which aim to match the performance of a particular index
- Exchange-Traded Funds (ETFs), which aim to match the performance of a specific index, industry or sector
- Mutual funds, which aim to outperform an index and are actively managed.
- Property and real estate
- Cash equivalents

Moreover, the investments present in the portfolio should correspond to different industries. For example, an investor could have government-issued bonds, different types of funds tracking the tech or healthcare industry, individual stocks in a specific tech or energy company, and more.

To further diversify a portfolio, investors should consider investing in international securities, as they are likely to react differently to market influences than local investments, mitigating the risk of those local securities. For example, tech spending in the U.S. may take a hit one year, while the tech industry in China may continue to thrive.

WHY IS PORTFOLIO DIVERSIFICATION BENEFICIAL TO INVESTORS?

By investing in different asset types and across other sectors and countries, an investment portfolio as a whole is subject to less risk, as each asset will respond differently to influences from the market.

So, even when part of the portfolio is exposed to an adverse market influence, this will often be counteracted by other investments which aren't affected – or are even positively affected – by that particular market influence.

Likewise, this doesn't just apply to different asset types and different sectors – it can spread across countries. Though a particular market segment may be performing poorly in one country, it may be performing well in another.

This is why international investments play a key, though less thought of, role in portfolio diversification – even if the stocks, bonds or funds are in the same sector as some of an investor's other investments.

Overall, this means that the amount of risk that your investment portfolio is subject to is minimised, and you're more likely to receive positive returns – overall – from your investments over a long-term investment horizon.

ARE THERE ANY DOWNSIDES TO PORTFOLIO DIVERSIFICATION?

Although portfolio diversification is a staple of the vast majority of investors' investment strategies, diversification does come with a few drawbacks.

For one, although your risk is significantly decreased – and the likelihood of reaping positive returns from your investments is heightened – you're also less likely to reap substantial short-term financial rewards from portfolio diversification.

This is in comparison to more 'high risk, high reward' strategies, such as investing in a few stocks from companies that you expect to grow inordinately in a short period.

Moreover, to have a truly diversified portfolio, an investor naturally has to have a reasonably large number of different securities within that portfolio, making it more time consuming to manage and often more costly.

This is because, typically, when you buy and sell securities, investors are subject to transaction fees and having a more extensive portfolio can make these add up and put a dent in the profit you earn from your investments.

However, investors can still diversify their portfolios and reduce the time and cost associated with diversification if they purchase investments such as mutual funds, which comprise a diverse range of securities across asset classes, and which can be traded at a lower cost compared to trading individual stocks of all the companies represented by the fund.

So, suppose you want to build an investment portfolio that's low risk and likely to bring reliable positive returns in the long term. In that case, you should consider implementing diversification into your investment strategy.

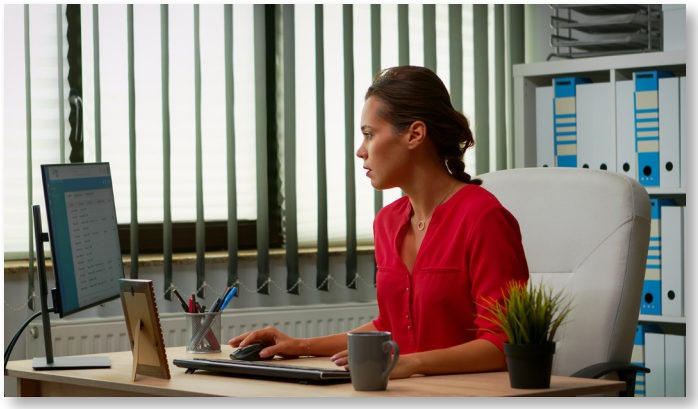
THE FOUR STAGES OF A PERSON'S FINANCIAL LIFE CYCLE

From the time we first begin to earn our own money to the moment we give up our income altogether as we enter our retirement, our lives tend to follow four stages that make up our financial life cycle, with each stage determining what we should be doing to nurture our financial health at that particular time.

With this in mind, here are the four phases most of us go through – and the accompanying financial milestones we experience – as we progress through our financial life cycle.

STAGE ONE: EARLY CAREER.

As we first enter our careers, securing our first full-time income in the real world – maybe we've just left home or recently completed higher education – we typically earn a smaller income than later in our careers.



Already, we may have accumulated debt during this period – such as student loan debt – and some in this stage of life even marry and start a family or borrow money to buy a house, often making loans and the subsequent debt unavoidable

During this time, the best thing you can do is develop good financial habits from the outset and – as much as possible – live below your means, spending less than you earn and saving as much as possible (unless you have high-interest debt that would be better paid off sooner, then you may want to prioritise paying this back over stockpiling your savings).

This is also the ideal time to plan your finances in the long term, considering where you want to be in the next few decades and figuring out how you're going to make that happen. And, if you can afford to, without compromising on your savings or debt repayments, this period presents an excellent opportunity to invest and make the most of long-term market growth.

Moreover, although at this stage, retirement seems like a lifetime away (and it nearly is), it's never too early to make a financial difference to your golden years by starting a Personal Pension Plan.

STAGE TWO: BECOMING ESTABLISHED

As a person becomes more established in their career, typically earning a higher income and having had more experience managing their finances, there is less emphasis on managing income and cash flow.

Instead, the focus is more on the management and growth of wealth. You may decide to invest in investments such as property to diversify your sources of income or invest in stocks or funds in the stock market – backed by research into the individual stock/fund, the economy as a whole and the investment strategies most likely to reap results for you.

In addition to growing wealth, this stage should be accompanied by detailed planning for the future, which may include saving for future expenses such as children's education, preparing for eventualities such as death and illness with insurance and wills and planning carefully for retirement, storing as much money away in retirement accounts as you can comfortably manage.

STAGE THREE: NEARING RETIREMENT

When you're nearing retirement, you'll be able to see more clearly whether the plans you've made in the earlier stages of your financial life cycle support the retirement you envision.

You may take this time to adjust your plan, considering any life changes that may affect the costs required for your retirements, such as health concerns or new ambitions for your retirement, such as travelling the world.

And, unlike the previous stages of a person's financial life cycle, you can conceive what your retirement is likely to look like since it's just around the corner. As such, you can begin to decide what withdrawal strategy you intend to use – some common ones include the 4% rule, fixed- withdrawals and systematic withdrawals – to best suit the funds you have and the lifestyle you intend to lead.

Moreover, this is the time you should be working towards paying off any outstanding debt, including mortgages, so that you can walk into your retirement debt-free, without the need to account for debt repayments within your financial retirement plan.

Lastly, as with every other phase in your financial life cycle, you should be doing what you can to increase your savings and grow your investments.

Reviewing your retirement portfolio regularly is just one of many ways you can take steps towards a life of financial independence and confidence. Adjusting your investment strategies based on your goals, age, and tolerance to risk can help you take control over financial stability in retirement.

STAGE FOUR: RETIREMENT

The golden years have arrived – but so has the time when you'll no longer have the reassurance of an employer-provided income. Instead, you'll be paying yourself from the finite nest egg you've accumulated over the earlier stages of your financial life cycle.

The critical consideration during this time will be not to overspend early – the last thing you want to do is to scrape by in your later retirement years because you made rash financial decisions in your first few years of retirement.

So, it's likely you'll want to employ the budgeting skills you learned in the first stage of the financial life cycle to ensure you can maintain your standard of living throughout retirement while accounting for the likely rise in health-related costs and the possible need for assisted living.

ONE OF US

In 'One of Us', we share intimate conversations with colleagues, thought leaders, and financial experts to educate, enlighten, and entertain you.

This month we caught up with our Consultant - Willem le Roux.

Q: Thank you so much, Willem, for taking the time to do this interview. Can we start by letting our audience know a bit about your background and your role with AMA?

A: Thank you, it is an honour to be featured in this month's edition of the AMA magazine.

So, I am from South Africa. I have an educational background in Statistics and Investment Management. I joined AMA in the Johannesburg office, where I was fortunate to work under and learn from some of the true legends in our industry, like our founding senior partner Greg Morris.

When I got the opportunity to represent our head office in Shanghai, my wife and I were nervous but took the leap of faith. I have lived in China for about two-and-a-half years now and have fallen in love with the place. In my current role, I construct and manage client investment portfolios, spanning the global investment market, including all major economies, industries and asset classes. I am also able to build my network here and help people from different countries and cultures around the globe with their financial planning goals. I work with people and investment markets daily. I then also help with internal training for new recruits and system changes to our database and CRM company-wide.

Q: What are your primary responsibilities as a Financial Consultant, and What areas of personal finance do you help your clients?

A: The number one responsibility is to understand each client's needs and aspirations and ensure that the solution I come up with works for their individual situation. If I cannot know where you currently are financially and what you want to achieve, then it doesn't matter how good I am at picking investments; it means I've then missed the point.

Other responsibilities include:

- Managing client's investments effectively.
- Following global markets closely.
- Performing industry and fund analysis.
- Identifying potential opportunities and warning signs in the market.

A big part of a successful relationship with any client is managing expectations and behaviours. Helping to make the right decisions and not be over-influenced by emotions when the market fluctuates. It is also essential for me to understand a client's changing personal situation and its impact on their outlook, risk tolerance, and goals.

Q: You seem to be a successful person. Not only in your studies and career but also your marriage. What skills, abilities, and personal attributes do you believe are essential to success?

A: Hahaha, thank you! That's a tough one, and I doubt the answer could ever be one-size-fits-all. Everyone is different, and as such, people could have vastly different views of what constitutes success. But, I guess a good starting point would be to identify what is important to you and who you want to be, and ultimately whether it will make you a happier person. Some people wish for career success; for others, it's fitness and health, family, influence, etc.

The most important attribute I could say is never to view yourself as a full glass of water. Acknowledge that you can continually improve and learn, and other people are better than you at something. Surround yourself with the people you want to be like, and learn from them. Also, recognise that everything comes at a cost. If family means everything to you, then you need to prioritise family above everything else. But be mindful of the fact that the price potentially is that the other guy at work who only has his eye on a career is going to work harder and will likely get the promotion before you do. That's fine, though, because you were never trying to beat him for the promotion, you wanted a happy family life, and that's what you've got.

I think it helps to have a role model, find someone who is successful in a way you want to be, but look at their life for all the positive and negative points, e.g. if you admire someone who is super-rich. It is easy to follow in footsteps of a successful businessman with respect at work. But, if he's been divorced four times and is in poor health, then also recognise that that is the price he paid, and consider if you're prepared to pay that price. You can't have it all.
Besides, I'm only 30 years old; I wouldn't pretend to know the answer to a successful life at this stage.

Q: What's the biggest challenge you have faced in your life so far?

A: We were coming to China, saying goodbye to our friends and family back home and starting a new life here. At times, as I'm sure most readers can relate, we have wondered, "what the hell have we gotten ourselves into, and wouldn't things be easier if we stayed put in SA".

However, like most challenges, coming to China has been such an eye-opener and made my wife and me much more rounded and open-minded people. Throwing yourself into the deep end is sometimes the best way to learn how to swim. We are happy we made the move and think that if we didn't, then we'd forever have looked back and wondered, "what if?".

Q: If you could do it all over again, would you choose the same path for yourself? If not, what would you change?

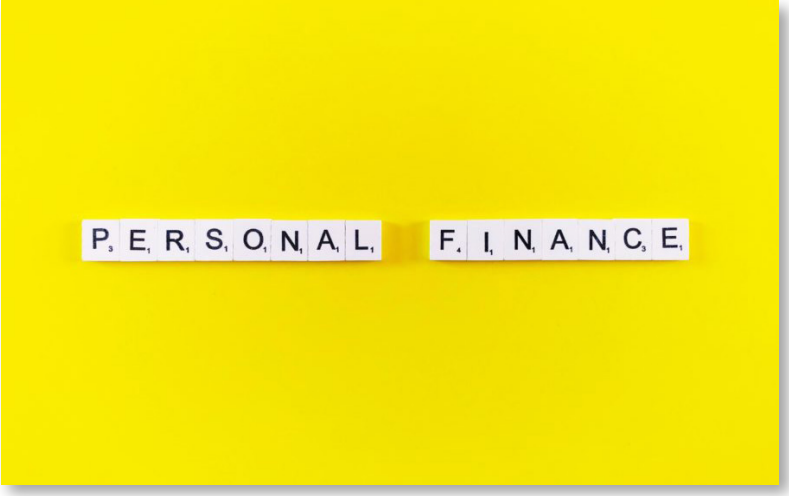
A: Hmmm. I had to think about this one. I guess if I could do it all over and forget that I've done it already, then yes, in a heartbeat. If I remember that I've already done it before, I'd do some things differently.

Q: We all know that you're an avid sports enthusiast. What sports do you enjoy the most?

A: Hands-down tennis is my favourite sport. I grew up with it, my wife and I both come from tennis families, and it's how we met. I also like watching any sport that gives me some conversation points with friends, but purely because I don't want to be the only guy at the table who can't talk about the fight over the weekend, the football game, or rugby.

A new sport came to China, called Padel, which is like a mix between tennis and squash. It's super fun, and I'd highly recommend it to anyone that enjoys racquet sports.

PERSONAL FINANCE 101



As financial literacy is rarely – if ever – taught in schools, most of us enter the world of personal finance blind, having to teach ourselves how to look after our financial health.

Simply put, personal finance encompasses the whole picture of how you make, save, manage and invest your money while working towards your financial goals.

Here are six things you should do to control your financial situation and make your personal finance the best it can be.

1. TAKE THE TIME TO UNDERSTAND YOUR FINANCES.

Before you begin revamping your financial situation, it's helpful to ascertain the state of your financial situation now.

A good way to do this is to look at all your financial incomings and outgoings over the course of a month, allowing you to gain an accurate view of your essential living expenses, discretionary purchases, ongoing subscriptions and other monthly payments, among any other components that make up the complete picture of your finances.

You can also use this time to identify where you can quickly reduce costs – and where you might be spending more than you need to – so that you can be more conscious of making similar needless purchases in the future.

2. IDENTIFY YOUR SAVINGS GOALS.

There are many different savings goals that a single person might have – and that they may even be working towards at the same time.

Arguably the most important of these savings objectives is creating an emergency savings fund – in case of sudden car or home repairs that need completing, or you're unexpectedly laid off or made redundant. For example, to give you a financial safety blanket and protect you from taking out loans and incurring needless debt.

Additionally, you may want to save for a deposit for a house, a new car, or your children's education – whatever the case, understanding your saving objectives are essential to building the relevant budget.

3. CULTIVATE A BUDGET.

Now that you have a fairly well-rounded picture of both your current financial situation and how you want your personal finance to look in the future, you can create a budget.

You can tailor your budget, taking into account the lifestyle you want to lead or the savings goals you want to achieve, or you can adhere to a pre-designed budget such as the 50/30/20 budgeting technique.

In this budget, 50% of your income goes to essential living expenses – such as rent, mortgage payments, bills, car payments, groceries etc. – while 30% is reserved for non-essential lifestyle purchases, and 20% is saved.

However, you may want to save more or less (though financial experts recommend 20% or more), and your living expenses may not account for 50% of your income, so you may want to 'splash out' more on the non-essentials, so you can adjust the budget to suit you.

Moreover, when budgeting, you should always 'pay yourself first, ensuring that the amount you've decided to save is directed into your savings account before anything else.

4. MINIMISE AND MANAGE DEBT EFFECTIVELY.

Ideally, this would mean always spending less than you earn and 'living below your means.

However, sometimes incurring debt is unavoidable. Sometimes, it can even be beneficial for the long term, such as student debt acquired from pursuing higher education (which may help launch a lucrative career). At the same time, mortgages allow for the acquisition of both a financial asset and a home.

So, if you do have debt, you should be working towards paying it off as soon as possible – without going so far as to compromise on your most important savings goals – prioritising your highest interest debt first.

5. USE A CREDIT CARD THE RIGHT WAY.

Though credit cards are often vehicles of debt accumulation when misused, they are also an invaluable tool to improve your credit score, which is likely to help you financially in the future.

Suppose you want to take out a mortgage or take out a lease on a commercial property. In that case, you'll need a good credit report, which can be improved by reliably paying off your credit card each month on time – setting up direct debts when possible to reduce the risk of late/missed payments.

6. INVEST.

More than staying aware of your financial situation, saving your money, and paying off debt, one of the best things you can do for your personal finance is investing your money and growing your wealth. There are numerous avenues you can take to help you achieve this.

To invest and grow money for your retirement, you might direct part of your income into a pension scheme. Or, if your employer doesn't provide this option, you could start a private Pension/retirement savings plan, through which you can choose to invest in stocks, bonds, ETFs or mutual funds with minimal effort and steady returns.

Likewise, you may choose to invest in stocks or funds to grow your wealth for use before your retirement, opting to employ an investment strategy to suit you and maximise the success of your investment.

THE DIFFERENCE BETWEEN LONG-TERM INVESTING AND TRADING

If you're looking to grow your money in the financial markets, then you've almost certainly come across the terms 'investing' and 'trading' as methods of profiting from market participation.

However, since both money-growing strategies can involve the same markets and similarly involve buying and selling stocks, it can be difficult to tell what these methods are and how they are different.

WHAT IS LONG TERM INVESTING?

Typically, investing involves buying and holding (keeping) assets – such as stocks, bonds and funds – to reward their appreciation over an extended period, which can be years or even decades.

This is usually despite short-term depreciation in these investments' value. In general, they are likely to recover in line with the market over time and return to – or improve upon – their original value.

WHAT IS TRADING?

Trading involves buying and selling stocks in the short term – which can be seconds, minutes, days, weeks or months – to make a profit by taking advantage of the fluctuating discrepancies in stock value.

For example, if a trader buys a stock for $100 and the stock's value increases to $120, then the trader selling the stock will make $20 in profit (minus the broker's commission).

On the other hand, traders can 'sell short' and sell securities at a higher price. This is based on the evidenced assumption that there will be a depreciation in the value of that stock and that the trader will be able to repurchase it later at a lower price – though this is a technique that requires the skill of a seasoned trader.

There are many different types of traders, each of which is categorised by the holding period they employ when trading, a.k.a. the period that the trader keeps their stocks for before selling.

THESE INCLUDE:

Day traders who trade stocks throughout the day – or just once per day – never hold overnight positions. In other words, stocks are bought and sold on the same day.

Swing traders who trade stocks daily or weekly, sometimes keeping their bought stocks overnight, resultantly holding overnight positions.

Scalp traders who buy and sell stocks rapidly hold their positions for seconds or minutes and never hold overnight positions.

Position traders hold their positions and retain the securities they've bought without selling for months or years.

WHAT ARE THE KEY DIFFERENCES BETWEEN INVESTING AND TRADING?

There are many differences between investing long term and trading in growing money in the financial markets.

The most significant defining difference between investing and trading is the difference in time that stocks are held. With investing, stocks are typically held for years or even decades to see monetary growth. At the same time, trading aims to make smaller profits more regularly – though outperforming long-term investments overall – by buying and selling stocks daily, weekly or monthly.

Likewise, the time involved in these money-growing strategies is usually massively different. Day traders are recommended to spend at least two hours a day trading, but many trade 40 or more hours a week.

In contrast, investors can choose to research, invest, then leave their investments alone to (hopefully) grow. However, many investors choose to put more time into their investment portfolio than this, carefully researching and readjusting their portfolio while implementing a carefully thought-out investment strategy to maximise reward in the long term.

Another difference between investing and trading is that to be successful when investing; an investor needs to research the market and the companies associated with the securities to determine whether they're likely to achieve long-term growth if invested.

On the other hand, traders don't focus on whether the company they're buying stocks from will achieve long-term growth. Instead, they search for and take advantage of mispricings of stocks. The stock is sold and purchased at a price that differs from the fundamental value of the stock. Traders typically use algorithms and technical analysis tools to detect and trade based on inefficiencies in the market.

Additionally, the budget required to invest versus trade looks very different. Most people with a few hundred – or even less – will be able to invest long-term in various stocks, bonds or funds, though they're able to invest much more if they have more disposable income.

In contrast, traders typically need at least $1000 to make any money within a reasonable period. More than this, some financial markets have regulations prohibiting traders with fewer than tens of thousands in their 'margin account' – a.k.a. the account traders keep their designated trading funds in – to trade, limiting those with a lower income from entering the trading game.

GROW FINANCIALLY WITH AMA

At Austen Morris Associates, we know how the right financial decisions can make all the difference to your long-term security, quality of life and the realisation of your dreams. We also understand the importance of working closely with you over the long-term to understand your unique needs and help to meet any challenges along the way.

Since 1994, we have been committed to the core values of trust, professionalism and partnership to the benefit of our International Clients around the world, resulting in the successful long-term relationships that are the foundation of Austen Morris Associates today. As Independent Financial Advisors, we provide unbiased advice and give you access to the world's top investment management groups.

Our Consultants offer a wealth of experience in providing a full spectrum of financial advice. Our commitment to ensuring your peace of mind reinforces our focus on trust and partnership. By focusing on your specific needs and situation, we tailor plans to reach your financial goals while maximising the benefits of international investing.

Austen Morris Associates is a truly international company with its global registered office in Seychelles and wholly-owned registered offices in China, South Africa, Hong Kong, Mauritius, the USA and the Philippines. To begin your journey towards total financial security, we invite you to meet with one of our Consultants to understand our financial planning approach and why our clients become loyal and long-term partners.

Get in touch with us today for a free no-obligation consultation.
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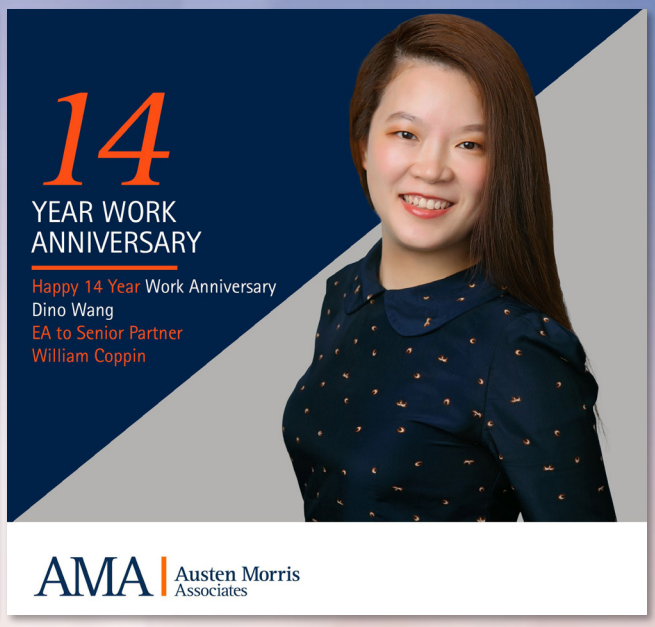
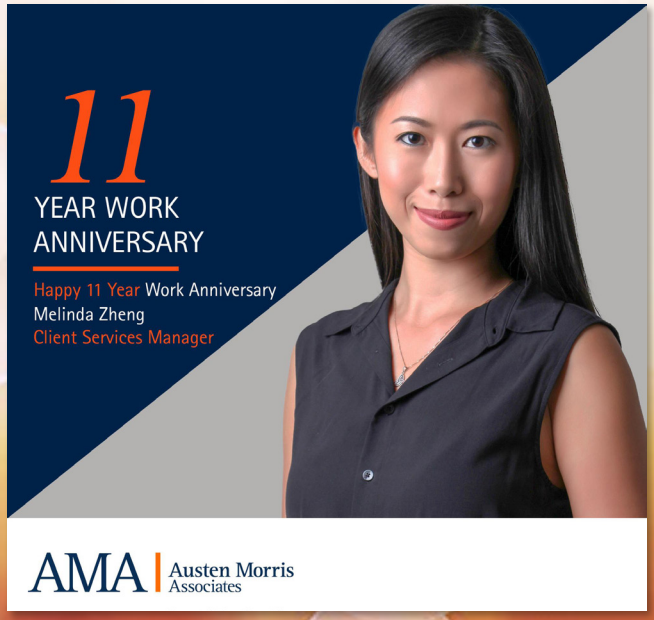
CELEBRATING SUCCESS





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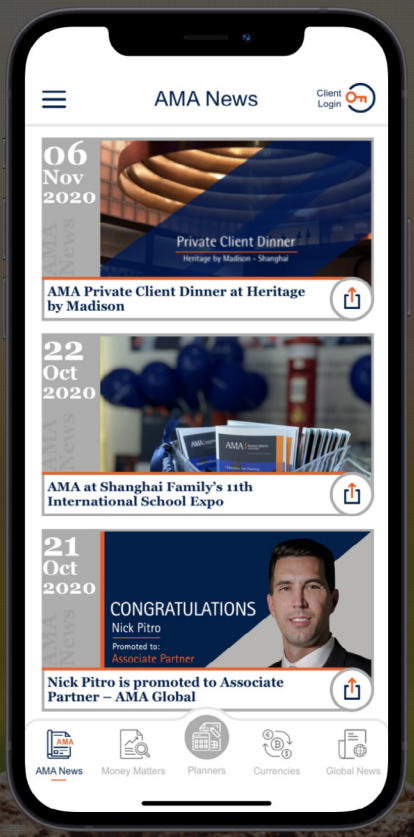

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