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Introduction by the Managing Director

Graydon Morris

Dear valued clients and friends

At the start of 2024, many investors were bracing for a challenging year, weighed down by persistent inflation, impact of 2023's monetary tightening, geopolitical tensions in the Middle East and uncertainty tied to the SA and US elections. Fast forward to December, and 2024 has surpassed even the most optimistic predictions. The US market is poised to deliver annual gains exceeding 25%, positioning 2024 among the strongest yearly performances of this century for that country (and second time that this level has been achieved in back-to-back years - last time was in 1954 & 1955). With markets still buoyed by the prospects of global rate cuts and improving US growth prospects, we are reminded that it may be a bumpy ride in 2025. We had a taste of this bumpiness as President-elect Trump announced his intention to introduce tariffs on Mexico and Canada, while increasing tariffs on Chinese goods.

To be fair, the rest of the world has not had it as good as the USA. At least here in sunny SA, we have been buoyed by a positive election result, and the early signs are that we are in a better place than we were before. Let us hope this is our reality for the next few years. The sentiment has certainly improved. I can tell you that the streets of Cape Town are full of tourists, what a wonderful sight to see!

I want to take the opportunity to thank all our clients, from the bottom of our hearts, for the great privilege of being entrusted with advising on your very valued capital. It is a job we take very seriously, and with great passion.

To this end, I also want to thank our Team at year end, for all that they do, every day, to provide the very highest level of service they can. The enhanced level of compliance, regulations and documentation required can be tiresome and frustrating, and our Team go out of their way to ease the pain on investors.

We have received so many clients thank you 's and commendations for our Team during the year; this is a testament to their unwavering dedication.

We wanted to end the year with just a few pieces to share with you, as relaxed reading fro the festive session.

As Bitcoin has scaled new heights, we have provided a piece by an old work colleague from Alexander Forbes days, Russell Chesler. Russell is a qualified actuary who has been in Australia as a senior financial services executive for many years. Russell guides us through the fundamentals of Bitcoin.

US Tech has had another bumper investment year, raising renewed concerns of a bubble in this area. Remember, the brutal sell-off in 2022 is just a recent memory. We have thus included a piece by Joe Wiggins, previous CIO at Fundhouse UK, on understanding financial bubbles.

The importance of portfolio re-balancing is a spoken about often in our office, and in our discussions with our clients. Trim some profits from a winning asset class, we do it often.

Humans Under Management have put together a simple guide to re-balancing and we have included it here for you.

And finally, we have included a piece by James Guimaraens, one of our directors, highlighting the importance of listening skills, in the advisor World. James is passionate about keeping things simple, and this issue shines through in his piece.

We wish you all a wonderful end-of-year-end break with family and friends and look forward to seeing you all safe and sound in 2025!

Best wishes

Graydon Morris
Managing Director

A Reluctant Investor's Guide to Understanding Bitcoin

By Russell Chesler

Many investors have, understandably, given Bitcoin a wide berth. Here's what you need to know as it gains in popularity.

Among the list of sweeping changes Trump has promised when he is sworn in as the next President of the United States are specific initiatives that support bitcoin, including retaining bitcoin as a government-held reserve. Accordingly, the price of bitcoin has been breaking records, with forecasts it will be at US$100,000 by year end. Regardless of your previous thoughts on bitcoin, it's worth understanding the basics, as it is clearly here to stay.

Many investors have, understandably, given bitcoin a wide berth, with its price ascension, volatility and lack of intrinsic value conjuring allusions to tulip mania and other speculative bubbles. However, the SEC ruling in the US earlier this year provided a crucial turning point for the cryptocurrency, establishing bitcoin as a legitimate asset, and paving the way for a flurry of bitcoin ETFs in the US and locally on the ASX. We could now be at the dawn of another pivotal moment for bitcoin, along with the broader asset class known as digital assets, with the forthcoming Trump presidency.

Currencies have undergone a number of evolutions in the last 100 years. It wasn't all that long ago that the world relied on physical gold - up until the 1940s, countries tied the value of their currency to the amount of gold they physically held. And it was only in the 1970s that the world moved to floating currencies, whereby value was determined by supply and demand. Following the creation of the euro zone, we saw the first region-based rather than country-based currency. And now we have global currencies via cryptocurrencies.

The digitisation of the world has completely transformed almost every aspect of our lives, so it should be no surprise that currencies and money are also being transformed.

Cryptocurrencies are digital currencies and can be used to pay for goods and services, just like we do with paper-based money, and as a store of value, like gold. A unit of cryptocurrency is known as a "token" or "coin", and these are stored in an online "wallet". In the same way we use specific exchanges for trading shares and ETFs, like the ASX and the NYSE, you can buy and sell units of various cryptocurrencies via specific online exchanges.

An important differentiator of cryptocurrencies is that they are "decentralised", meaning they operate independently of any government or bank. Traditional currencies are managed by a country or region's central bank, which influences its value via changes in interest rates, and supply controls via monetary policy. Cryptocurrency prices are not beholden to such influences.

Relying on an encrypted peer-to-peer system of exchange, cryptocurrency is derived from the word cryptography - the process of coding information so only the person intended to receive said information can decipher it. However, while we've come a very long way since The Enigma Code, investors should be mindful of the risk of crypto wallets and exchanges being raided and assets stolen. According to reports, hackers stole in excess of US$2 billion in cryptocurrency in 2024.

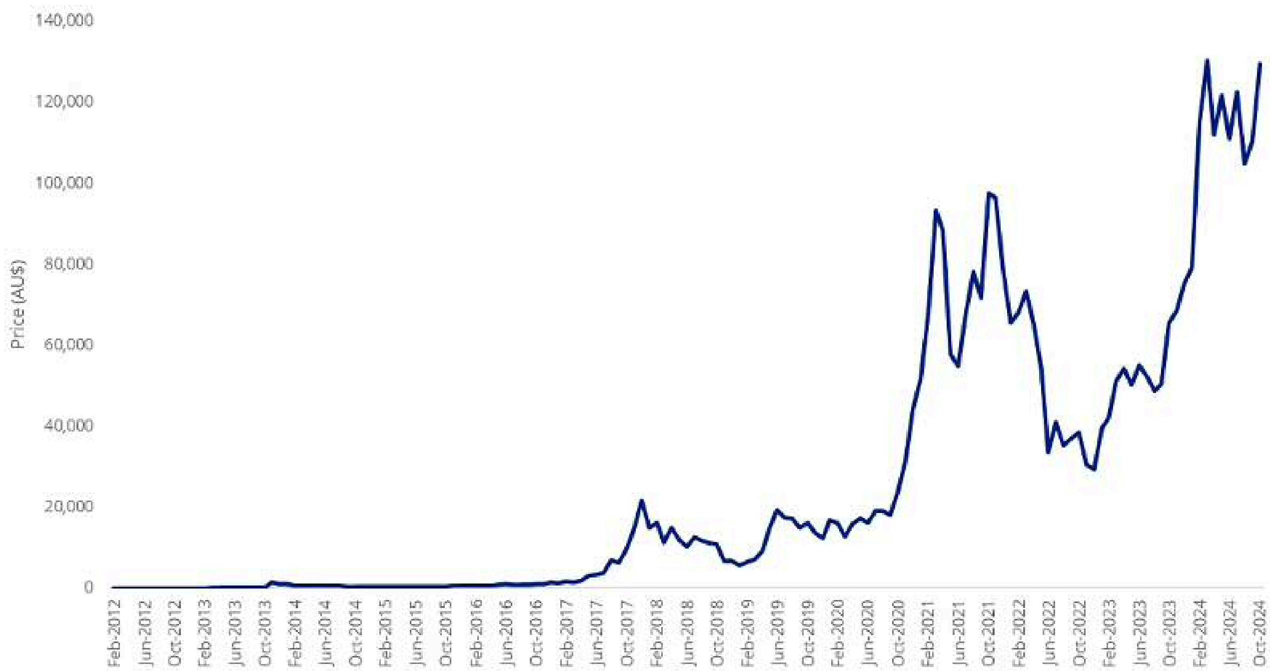
Bitcoin 101

Bitcoin is the most established and accepted cryptocurrency. It has become a significant currency both on- and offline and currently has a market capitalisation in excess of US$1.8 trillion1, which is higher than Berkshire Hathaway and Tesla2.

Now, more than ever, merchants and businesses are accepting bitcoin as a form of payment and infrastructure has been built to make it more convenient for the average person to use. The development of user-friendly wallets, exchanges, and marketplaces has removed the technical barriers to entry that existed in bitcoin's early years.

Since inception in 2009, bitcoin's increase in value has been extraordinary. From trading below the US$500 mark in its early years, its current value hovers around US$90,000. Bitcoin's historical performance can be characterised as extremely volatile yet upward trending.

Chart 1: Since 2013, bitcoin's price has experienced dramatic highs and lows



Source: VanEck, Morningstar as of 31 October 2024. Representing the price of bitcoin is the MarketVector™ Bitcoin Benchmark Rate. Past performance is not indicative of future performance.

Like gold, bitcoins are produced via "mining". Only, instead of using specialised mining equipment such as drills, explosives, longwalls and excavators, bitcoin miners use hyper sophisticated computers to compete to solve complex mathematical problems. Bitcoins are the reward.

There will only ever be 21 million bitcoins in existence. This supply cap was designed intentionally and is one of the primary characteristics of bitcoin.

Furthermore, bitcoin has "halvings" programmed into it. At each halving, bitcoin miners will earn half as many bitcoins as they did prior to the halving event. Halvings occur roughly every four years and result in a slowdown in the rate at which new bitcoins are introduced into circulation over time until it eventually reaches zero (estimated to occur around the year 2140). The last halving occurred on 20 April 2024. Historically, the price of bitcoin has rallied leading up to and following a halving.

While increasing scarcity can lead to increased value, investors have also been attracted to bitcoin as a portfolio diversifier. Bitcoin has a low correlation to traditional asset classes.

Chart 1: Since 2013, bitcoin's price has experienced dramatic highs and lows

Asset class	Bitcoin	Australian bonds	Global bonds	Cash	EM equities	NASDAQ 100	Global equities	A-REITs	Australian equities	Gold
Bitcoin	1.00									
Australian bonds	0.08	1.00								
Global bonds	0.17	0.82	1.00							
Cash	-0.02	0.19	0.19	1.00						
EM equities	0.13	0.22	0.33	0.10	1.00					
NASDAQ 100	0.26	0.38	0.36	0.10	0.40	1.00				
Global equities	0.28	0.35	0.32	0.12	0.47	0.86	1.00			
A-REITs	0.25	0.43	0.55	0.09	0.40	0.46	0.64	1.00		
Australian equities	0.27	0.25	0.37	0.03	0.49	0.50	0.67	0.83	1.00	
Gold	0.00	0.32	0.21	0.15	-0.03	-0.09	-0.13	-0.09	-0.27	1.00

Source: Morningstar Direct, Ten year correlation, 31 October 2024. Indices used: Australian Bonds is Bloomberg AusBond Composite 0+Y Index, Global bonds is Bloomberg Global Aggregate TR Hdg AUD Index, Bitcoin is MarketVector Bitcoin PR Index, Cash is AusBond Bank Bills Index, EM equities is MSCI Emerging Markets Index, Global equities is MSCI World ex Australia Index, A-REITs is S&P/ASX 200 A-REIT Index, Australian equities is S&P/ASX 200 Index, Gold is LBMA Gold Price PM.

Bitcoin as a mainstream asset class

The approval of bitcoin ETFs by the SEC and ASX has enabled the wealth management community and individuals to access bitcoin via a regulated and insured investment vehicle, opening up the asset class to institutional investors including hedge funds, sovereign wealth funds, pension funds, and registered investment advisors. The Trump administration plans to further solidify the cryptocurrency as a mainstream asset.

Trump was the first Presidential candidate to brand himself "pro-crypto". Among his pledges were:

- A strategic national crypto stockpile;
- A change in direction, in terms of approach to regulation and from the aggressive stance taken under the previous administration;
- Ensure the US is the global centre of bitcoin mining; and
- Fed rate cuts, which have historically boded well for bitcoin.

According to a latest Australian Investor Survey, more than 1 in 10 respondents are considering investing in a bitcoin ETF in the next 12 months. Meanwhile 95% Australian financial advisers would consider allocating to a bitcoin ETF, according to the 2024 VanEck Smart Beta Survey.

A Bubble Repeat: or it is Different this Time?

Joe Wiggins

Back when I started my career in 2004, I remember that virtually every client account I looked at had tiny allocations to technology-oriented equity funds. I was initially puzzled by this before realising that these now inconsequential holdings were once significant but had been eviscerated in the denouement of the Dot-Com bubble. Looking back on such periods of exuberance and collapse it is easy to think that avoiding similar situations is straightforward. This could not be further from the truth – although the underlying stories may change the behaviours do not. Speculative bubbles are an inherent feature of financial markets.

There are four aspects that are key in the formation of a bubble: A compelling narrative, strong performance, powerful incentives and social proof. Narratives provide the foundation and ongoing support for a bubble, high returns corroborate the story, financial incentives are the reason why people become involved at all, and social proof encourages action (we care deeply about what other people are doing.)

Although predicting when a bubble may occur is likely a fool's errand there are inevitably factors that increase the probability that a certain asset may be susceptible. What are the features of an asset or the themes supporting it that increase the risk of a bubble?

1) True and simple stories: Although the underlying narrative supporting a bubble does not have to be true (sometimes they can be nonsense) the most dangerous are those which are supported by a valid and simple story.

2) Transformative stories: For bubbles to successfully emerge it needs to be easy for investors to disregard traditional approaches to fundamental investment valuation.

3) Everyday impact: If we can see and experience the story unfolding then we are more likely to buy into it.

4) Unquantifiable scale: A genuine bubble needs an asset where the transformation taking place means that it is difficult to limit the upside potential.

5) Difficult to value: The most significant bubbles can occur in assets that are either difficult or impossible to value. If you cannot value an asset, who is to say what the upside could be?

Although difficult to validate, my base case would be that the potential for bubbles or prolonged periods of very extreme asset class performance is greater than ever before. Increasing connectedness through the rise of social media makes for easier amplification and transmission of stories, while I would also argue that investor time horizons are contracting – making us more prone to chase the performance of whatever is working.

As a bubble inflates and the story becomes ever more persuasive, the increasing cost of missing out is likely to overwhelm the increasing risk of disastrous losses.

Rebalancing: The Disciplined Investor's Secret Weapon

Humans Under Management

In any investment portfolio, it's normal to find that one asset class has outperformed the others in the recent past. Our minds, being extrapolation machines, often assume that what has happened in the past will continue into the future.

This causes us to be drawn to investments that have performed well recently, hoping their strong performance will continue. This behaviour is unique to investing; in most other areas of life, we generally look for good value. We rush to the shops when there's a sale, not when the price has recently increased.

In reality, however, rather than recent price movements continuing forever, investment asset classes tend to "revert to the mean." Assets that have recently performed well go through a period of disappointing performance, while recent underperformers make a comeback.
To fight the natural urge to chase performance and take advantage of the market's cycles, the disciplined investor has a secret weapon.

The Benefits of Rebalancing

When asset classes experience different returns, it's normal for a diversified portfolio of equities and bonds to no longer align with the original investment strategy.

This is where rebalancing comes into play. Rather than being tempted to shift more assets into the performing asset class, rebalancing is periodically adjusting your investment portfolio to return to your target mix of assets. This means reducing the allocation to the asset class that has performed well and buying more of the asset class that has performed poorly.

While counterintuitive, it's a powerful tool that can help counteract our natural impulses and keep our investment strategy on track. When you rebalance, you sell some of the best-performing assets (which have become more expensive) and buy more underperforming assets (which have become relatively cheaper). This systematic approach helps you capitalise on market fluctuations without trying to predict them.

Another significant benefit of rebalancing is ensuring your investments align with your financial goals and required return. As markets shift and certain assets outperform others, your portfolio can drift away from your original target allocation. Regular rebalancing corrects this drift, keeping you on track with your investment strategy.

Lastly, in a world where short-term thinking often prevails, rebalancing encourages you to focus on your overall investment strategy. It reminds you that investing is a long-term endeavour and helps you avoid reactive, emotion-driven decisions.

Discipline Triumphs Predictions

Successful investing is about consistency and discipline rather than trying to time the market perfectly. The goal isn't to predict which investments will perform best in the short term but to maintain a diversified portfolio aligned with your long-term goals. By rebalancing, you're positioning yourself to benefit when these trends reverse, as they often do over time.

The most straightforward approach to rebalancing is to schedule an annual review of your financial planning and rebalance at that time. At this time, the asset classes that have performed better are reduced in favour of asset classes that have underperformed. In effect, the investor is “selling high and buying low.”

This is best done with the help and guidance of a caring financial adviser. As always, your unique goals, circumstances, and tax planning should also be considered.

By working together to implement a robust rebalancing strategy, we can help ensure that your portfolio remains aligned with your goals, regardless of market fluctuations.

A few weeks ago, I was attending a trustee meeting with a client of ours, his spouse, the professional trustees, and our client’s tax advisor. He is a competent and successful entrepreneur with experience in the financial services industry, and therefore well-informed on financial matters.

After we had endured the interminable compliance-related items on the agenda, including the financial statements, he asked a straightforward question about the future distributions to family members on his eventual demise.

The response from both the professional trustee and the tax specialist was so convoluted and technical, that even I started to lose focus and interest. I almost forgot the original question. I also observed my client and his spouse rapidly losing interest. They did not understand the answer!

The problem here was not the client.

The problem was that the professional trustee and the tax advisor did not understand what my client was asking. They listened, but as my client framed his question with context, they were already preparing their answer, as they saw it. They had stopped listening.

Does your Advisor Listen?

James Guimaraens, Sterling Private Wealth Director

WHAT IS THE QUESTION?

A client called me to ask for advice on buying a new car. His question was whether he should finance a new car or whether they should draw capital from their portfolio.

His question was quite simple, but I found myself complicating the answer beyond what he had asked.

I began my answer explaining the opportunity cost of the purchase, and I then intended explaining retirement planning, cost of ownership of the vehicle and insurance. But then I realised I was making the same mistake as my colleagues in the trustee meeting several weeks ago.

I stopped talking, and then I answered his original question. He should draw capital from his portfolio because the finance costs would be exorbitant.

DO YOU UNDERSTAND?

We were asked for a second opinion on an investment portfolio review prepared by another wealth management practice. Our client's family member was unhappy with their investment portfolio and was researching other companies.

I was impressed with the portfolio review, and surprised they were dissatisfied. When I queried why she was looking for another person to look after her financial affairs, the answer was insightful and revealing.

"They don't listen to what I'm asking, and I don't understand what they are doing".

The portfolio review report was a formidable document, beautifully printed, and included pages and pages of information on the underlying funds and performances. It ticked all the compliance boxes and presented detailed information in multiple formats.

The wealth manager in question was going to lose a client not because of performance concerns, but because they hadn't listened. The report didn't clarify what the client wanted, what she should expect, or how they were achieving it.

The review report was designed by the wealth management business to tick all the marketing and compliance requirements, but they had forgotten about the client.

A TWO-WAY PARTNERSHIP

I was asked by a friend of mine, "What do you actually do?" I thought about it, and answered as follows:

"We ensure that you pay attention to your personal financial affairs at least once per year. We also pay attention to the detail and take care of the complexity so that you do not have to".

Most individuals do not have the interest, the inclination, or the time to ensure their personal finances are reviewed on a regular basis, and they usually do not have the knowledge.

This two-way relationship is only successful if both parties understand each other. Your obligation is to be open and honest in your communication, and if you do not understand, say so. Our obligation is to ensure that we listen and pay attention to what you are asking, not what we think you are asking.

WHAT WAS THE ANSWER?

In the example I used at the start of this article, I called my client after the meeting, and queried if their main concern had been addressed in the meeting?

Their question had not been addressed because they didn't understand the long-winded answer.

I was able to summarise their answer in a few sentences, by removing the unnecessary detail and in doing so I resolved their concern.

And that is what we should do.

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