THE STORY OF A VERY ROUGH DIAMOND

A lesson for investors: It takes years for this mineral to turn into something precious

In my first column of this year, I cast my mind back over an investment career spanning three decades and listed the most stressful periods I had been through. One was when Russia defaulted on its domestic debt in August 1998, leading to a global emerging-market crisis. The South African stock market was not spared: the JSE all share index shed about 25% of its value practically overnight.

As I mentioned in that piece, it didn't help that I had a geared position in my personal capacity while I was stressing on behalf of clients. I said this was a topic for another day. Today is that day.

I was still a very rough diamond at the time, with barely two years of investment experience. My colleagues and I had just lived through the merger of financial services business Capital Alliance (my employer) and private equity manager Capital Partners. The newly formed entity was the original Brait. (Did you know that the name of this company refers to a rough diamond?)

The firm listed on August 1 1998, just a couple of weeks before the Russian crisis. As part of the process, the group raised a chunk of capital to fund the many profitable deals looming in our future. The roadshow to institutions was received well and oversubscribed at a blue-sky valuation.

Management was kind enough to let a select few employees participate in the listing at the same price. No problem if you didn't have any spare cash: there was a bank in the group, so loan finance at a market interest rate was quickly put in place. I was younger than most and not particularly senior, but I was allowed into this privileged group. I was part of the investment team and thus considered to be "sophisticated" enough to understand the risks.

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Learn the hard way

What could possibly go wrong? I was on to a sure thing with a nice stake in a tree that was about to grow to the sky. And the group had upstanding professionals like me as debtors, with beautiful, brand-new share certificates as security.

There was a catch: we couldn't sell until after three months. So when the crisis hit, we were fully exposed, facing paper losses of more than 80% of what the shares had been trading at. Worse still, the interest rate on our loan financing was bumped up by 10%, in concert with the Reserve Bank hiking rates by a similar percentage to protect an ailing rand.

I was bankrupt for a few weeks while this was playing out. It was not an enjoyable time.

But all's well that ends well: the Brait share price eventually started to recover and interest rates came down. By the time I had to settle my debt, I had lost "only" the equivalent of a Toyota Corolla (and fortunately not my house, which had once been in play — at least theoretically).

This experience taught me a few things. First and foremost, every investor needs to be a little less greedy and a lot more patient. The really profitable outcomes seldom happen overnight — good things come to those who wait.

I also got to understand my personal risk profile. In my current day job, I am responsible for determining this on behalf of clients in consultation with them. In the late 1990s, I didn't really have a clue about my own risk profile when it really mattered. To misquote Mike Tyson: every investor has a great appetite for risk, until the market punches them in the face.

More than anything, I learnt about the dangers of borrowing money to invest in a single high-risk position. Yes, such a strategy may enhance your returns very nicely when everything goes in your favour, but most investors should probably steer clear of this approach. If you do the basics right — invest in a diversified portfolio of quality stocks and give it time — the market tends to reward investors adequately without them having to spend night after night worrying about a geared position.

I've never shared this story in public; a professional money manager having their personal balance sheet dipping into the red once is not good for the CV. Please don't tell anyone. **x**

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