ARE BLUE CHIP SHARES SAFE AS HOUSES?

Whenever people talk about investing in shares, they typically refer to large companies as “safe” and smaller companies as more risky. While it is true that large companies are less likely to disappear overnight, it would be a mistake to think that they are not risky. Any investment in shares should be considered risky, this is the price you pay for the potentially high returns that they can provide over time. It is the more risky, smaller companies that offer patient investors the best returns over time.

BIGGER IS NOT ALWAYS BETTER

According to research from Cannon Asset Managers, you can be handsomely rewarded for investing in smaller companies on the JSE rather than larger companies. Cannon calculated that if you had invested R100 in small companies (small caps) on the JSE 20 years ago, you would now have R838. This is significantly better than a similar investment in the Top 40 shares on the JSE where you would only have R521 today. It proves the point that you can be rewarded for taking more risk but you need to be really patient with your investments.

If you are a fan of Blue Chip (Top 40) shares it is worth noting that you cannot simply buy and forget these investments – unless you are an index investor. According to Cannon, only 8 out of the top 40 companies in 1990 are still in the top 40 today. The rest have disappeared, been bought out, delisted or collapsed. Therefore it is important to realise that your Blue Chip shares are probably not as safe as you think and when the stock market becomes irrational (I think we are there now) some of your Blue Chips might be your most risky investments of all.

ACHIEVE A BALANCE

I’m certainly not advocating that you sell all your large companies in favour of smaller ones, rather focus on achieving a balance. Out of every R100 you have invested in shares, you might consider investing a maximum of R20 in smaller companies. If you are an index investor, you could consider adding a Rafi ETF to your Top 40 ETF or a Divi ETF. Personally, I am a fan of indexed funds that invest in the top 100 Swix shares as you tend to have a greater exposure to small/medium sized companies as well as some of the behemoths of the JSE.

If you are a direct investor in shares i.e. you tend to buy your own shares via a stock broking account, you can find some fantastic small companies that are offering real opportunities to investors. In addition, most of the large fund managers and research houses tend to avoid the smaller companies. This means that a patient investor who takes the time to do proper research into this sector might have a competitive advantage over the rest of the market. Be careful of some commentators on Twitter who claim to be small company experts. They might be clueless or are promoting shares they already own. This is a very old tactic but social media has made the problem much worse.

Rather do your own research or rely on research provided by experienced analysts or fund managers that have proper research models for smaller companies.

The stock market is such a dynamic and varied universe of businesses that you need to be careful of grouping companies together and expecting them all to be the same. Just as there are wonderful large businesses on the JSE so there are some wonderful small companies offering great opportunities – you just have to know how to find them.