From IPO to REPO

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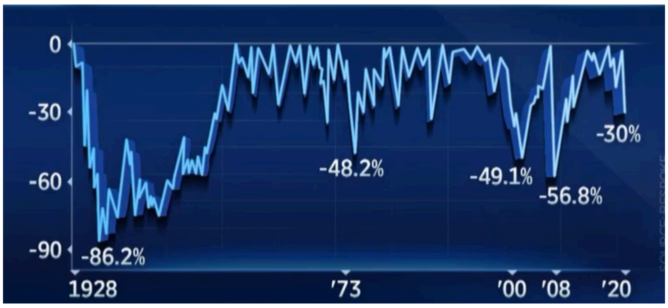
Human memory seems short, doesn't it? During a relatively brief career, I have experienced three major market corrections – obviously all for different reasons. Someone once said that happy families are all alike, but every unhappy family is unhappy in its own way – markets are the opposite! Markets are "happy" for different reasons. Shortly after the Dotcom crash during early 2000, I read this headline "*From IPO to REPO*" (from initial public offerings on the Nasdaq to assets being repossessed). The excesses of the technology boom stuck with me.

Since 2000 we had two more major corrections and several intermittent market pull-backs (probably in the order of 20%). The 2008 GFC (Great Financial Crisis) and then, out of nowhere, the COVID lows of early 2020. All three remain the most severe in recent history. The few years subsequent to the GFC were as scary (and uncertain) as they could be. The stock market collapse of almost 90% during the late 1920's, which eventually spilled over into the Great Depression, seem the worst and also took the longest to recover.



(*Source: CNBC 2020*)

Volatility has been and will remain part of investing. **The inevitable and unavoidable is on the way**. We don't know what will trigger it, how it will play out or when it will happen, but the next correction is definitely in the making. Peter Lynch, the famous and very successful investment manager, once said: "*More money has been lost in anticipation of a correction than in the correction itself*". Unfortunately, we cannot sit here and wait on the side-line until these unknown events play out. Financial markets tend to influence us in subtle ways. Fear and greed drive investors, **but investing is ultimately a rational attempt of positioning funds (or capital) so that we profit from compounding and future developments**; i.e., economic growth – the advancement of society with productivity gains (producing more with less effort, or resources). This is where human ingenuity and new technologies make the most difference.

We work with the future in mind, but we cannot predict the future. When we operate with probabilities and outcomes, it is not a matter of whether you are right or wrong. It's how much you benefit when you are right and how much you lose when you seem to have made a mistake. This is all part of a well-crafted financial plan and investment allocation. It keeps us in-check.

Making volatility your friend, not foe

A good investment strategy should be for the long-term. In laymen's terms, what does long-term imply? I suppose that differs for each person given his or her age, but this could be approximately 15 years or even longer. A particular strategy might seem fine when everything goes well – almost as if we get something [returns] for nothing, or very little effort. Investment balances compound by itself until something gets undone. Remember though, you have not lost anything until you have sold out. Well, the saying goes, "there is no free lunch". What is the price for better outcomes? Everything worthwhile has some sort of sacrifice, or price we need to pay. It is hard (for most of us) to stick to a financial plan and investment strategy when financial markets collapse.

Morningstar research in the United States looked at more than a 100 funds that deploy a tactical investment allocation. In other words, these fund managers try to anticipate market movements by selling high and buying low (it is an over simplification of the process, but it illustrates our point). Less than 10% of those managers were able to outperform a simple asset allocation strategy over a rolling 10-year period – diversifying across cash, bonds and equities which creates a smoother ride. Some investors try to take short-cuts, but do not achieve their intended results. Why do people pay for quality food, a reasonable lifestyle or a holiday, but try to avoid the "price" for reasonable returns? In this particular case, the price is not so obvious as a price-tag. **Returns require patience while accepting volatility**; i.e., the ups as well as downs. As Morgan Housel, a respected writer on financial matters frequently stated, it might help us if we look at volatility as a fee instead of a fine. A fine is typically for something you did wrong. Market volatility should be our friend and there is a price-tag for our patience over time. How would you feel if your investment balance suddenly drops by 15% to 20%?

Being a pessimist is easy

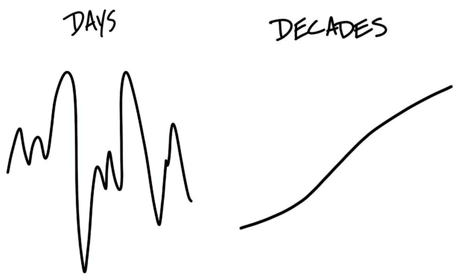
Just try to imagine those depression years. What about those years after the second world war? The headlines shortly after the 2008 GFC were absolutely dooming. Now, look back and consider how circumstances have changed for the better. English poet John Masefield said: "*To most of us the future seems unsure, but then it always has been. Those of us that have seen great change must also have great hope*".

What has the previous decades shown us? **The world tends to improve incrementally and will continue to do so**. Healthcare and technology will change the quality of life for the next generation (we might not notice it from day to day, or month to month). Being pessimistic may sound wise or plausible. Individuals tend to anchor their beliefs on the most recent (and familiar) events – especially if they were painful. However, when we study data, financial markets have risen more times than it has receded – statistics is on our side!

The pain of a perceived loss looms larger

No one likes to lose. For the same unit, a loss versus a gain, the pain of **a loss feels worse to us** – that is a R100 loss versus a R100 gain. We like to win, but definitely hate to lose. Scientists call this behaviour *loss aversion*. If we understand how we are wired, we could also make better investment choices for the long-term.

You decide what to focus on…



(*The sketches are by Carl Richards from the Behavior Gap*)