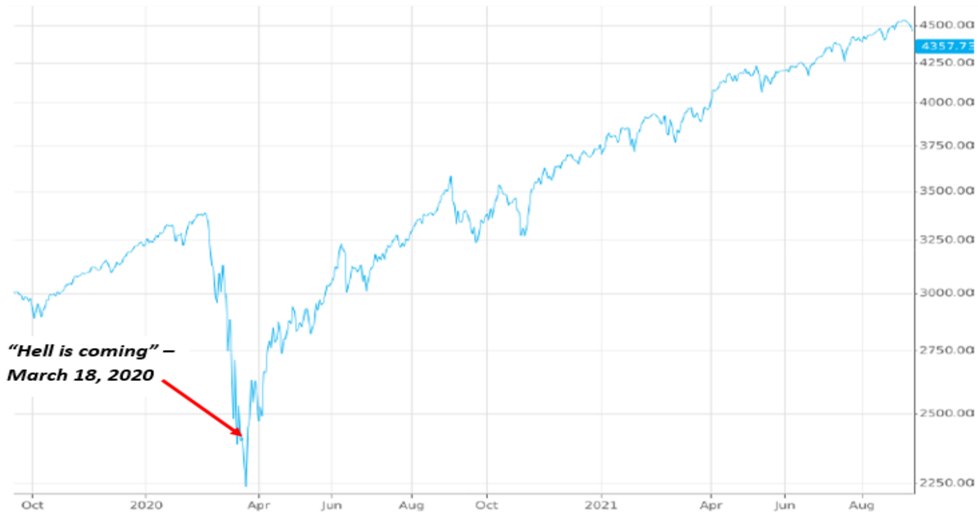
Staying the Course and avoiding Short-Termism

Our ability to access information at a moment's notice is both a blessing and a curse. Being constantly connected has changed our lives, in many ways, mostly for the better. However there are also potential pitfalls in the form of information overload and misinformation. For some investors this can lead to short term thinking and ill-timed decisions. Adding to the confusion are the interviews and debates on business channel programming, discussions among a myriad of contributors and guests. Here's where the casual viewer can gain some knowledge, but can also be led to the triggering of two very basic emotional responses, fear and greed (including "fear of missing out" – FOMO).

When it comes to investing, emotions are an investor's worst enemy. Think back to the onset of the pandemic, and the large daily declines in the stock market indices. It's natural for one to extrapolate from a big down day in the markets, and fear the worst. Yet acting on one's fears at that moment in time would probably have been financially damaging. The belief in "I can sell out now, and get back in later at lower levels" is, in most cases, wishful thinking. If the market did decline much further from the fear induced sell, it is more likely that the feeling one has is relief, having "gotten out", rather than a want to get back in, and invest at those lower levels. The desire to come back into the market typically occurs only after the worry of the worst case scenario is over, likely at a higher price point. Through this entire process, all of the analysis that actually matters, is frequently ignored.

Last March, near the depth of the market lows, a well-known hedge fund manager was on CNBC, warning that "Hell is coming" (Chart 1). The market bottomed one week later. Investors selling their investments prompted by this interview would probably have felt relief for a week, but regret thereafter, since they likely missed out on one of the largest market recoveries in history. It's probable that the same investor would have doubted

Chart 1: S&P 500 – 2 years



Source: FactSet

the market recovery, until they feared missing out on further market gains, “FOMO”. Commentators, prior to the presidential election, had warned that a Biden victory would be devastating for the fossil fuel sector, and a windfall for the solar energy sector. While the economic shutdown led to a particularly poor performance in oil and gas stocks last year, it has been the oil and gas sector that has outperformed since the election results and, since inauguration, clearly not the expectations of most market participants. During this period, the solar energy sector has done poorly.

Keeping an eye on the prize (the goal)

What is frequently lost in all the noise, is the most important consideration, the financial goal. A well designed portfolio will make it easier to not lose sight of that goal, despite either market volatility or short term opportunities. Rather than focusing on the here and now, a portfolio should have diverse sector and regional exposures, and not be pointed all in one direction for a specific short term outcome. This does not mean however, that there cannot be bigger portfolio weightings for higher conviction opportunities. Using this discipline will likely lead to a reduction in portfolio volatility compared to that of a portfolio with bigger short term bets on a specific outcome.

Looking towards next year

Stocks continue to be a more attractive asset class over bonds and cash, even more so after the recent September pullback. Investor sentiment has declined with continuing worries about the spread of the Delta variant, possibility of bond tapering (reduction in government bond purchases), inflation pressures and most recently, concerns about the likely default of a large property developer in China. There also continues to be lingering effects of last year’s economic shut downs on the supply chain. But our view is that the goldilocks scenario is firmly in place, the conditions being just right for stocks to advance in the coming twelve months. While we need to be on alert regarding the risks, the upside versus downside in stocks is much better than in bonds or the negligible returns in cash. In fact, at this juncture, we would even prioritize cash over bonds as we see the potential for a slight negative return on bonds in the coming year. Simply put, we prefer to “look through the short term noise” and invest based on a more sustainable medium and long term theme.

Rather than taking “big bets” on a particular outcome, we see the barbell approach that we’ve been using over the past year to continue to provide the best combination of risk adjusted returns for portfolios in the coming twelve months. We favour exposure to both the secular growth stocks that are benefiting from the digitalization of the economy, and to the old economy cyclical recovery stocks that will benefit most from stronger economic growth.

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