Damned if you don't… price vs value

Money Matters

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With the US stock market now entering its 11th year in a bull market, it is probably a good idea to reflect on some old age wisdom, which is nicely explained by the following quote: "Bull markets are born on pessimism, (think back to 2008/9 after the collapse of Lehman Brothers, who in their right mind wanted to invest), grow on scepticism, mature on optimism and end on euphoria."

The question is where in the cycle are US markets today. The reference to the most hated bull market in history is a clear sign of the scepticism, which has been a hallmark of this extended bull market, however last year's phenomenal returns seems to have brought about a change in sentiment, which now resembles euphoria, recently epitomised by Donald Trump's claim that he is somehow responsible for four US companies (Apple, Amazon, Microsoft and Google) now valued above $1 trillion respectively.

You will hear market commentators refer to a bottoming of global growth underpinned by low inflation and low interest rates, which is expected to continue to drive earnings and therefore potentially even higher share prices, but I would be cautious at this stage…

The difficulty for investors is the proven fact that it is impossible to call the top and/or bottom of a market cycle and as herd animals it is very uncomfortable for us intuitively to go against the herd. We would rather be wrong with everyone else than risk being wrong all alone.

What we do know is that to generate real (inflation plus) returns we must be invested in the stock market, what we don't know is how the stock market is likely to behave or should I say misbehave over the short-term and when I say short-term I am referring to the next five years. It's almost a bit like saying "you're damned if you do and also if you don't".

Warren Buffet, arguably the most successful investor of all times, has the following bit of advice for investors: "Be greedy when others are fearful and be fearful when others are greedy." He is of course referring to our "herd" behaviour, which we find so difficult to avoid. If we can't time markets and we need to be invested, what should we do when markets appear to be at euphoric levels?

Quite simply we should not be buying the broad market. This is where and why active management underpinned by a value philosophy has been such a successful investment strategy through the ages and will survive the recent rise of passive investment solutions, which offer low cost participation to the broad market. Most passive investment solutions are price/value agnostic effectively buying the market at any price with the obvious risk of permanent loss to capital.

Now is the time for bottom up value-based investing, where price vs. value matters. – *www.mwwealth.co.za*