Irrationality causes volatility

Money Matters

Mark Williams

The share prices are not irrational, the investors are.

When the stock market behaves like a yo-yo it is good to remind yourself of what a share price really is and that is a daily offer from someone to buy and/or sell you a business. If you are the business owner, why would you ever entertain a lousy offer to buy your business? You would simply laugh it off.

Private equity or business owners have an advantage in not knowing and/or caring what someone is prepared to pay them for a business they have no intention of selling. So why then do investors panic when the Naspers share price falls from R3 000 to R1 800? Does it matter what the share price is today or tomorrow? You still own the business, right? Who cares what some fund manager in New York is offering you for your shares?

This explanation may be a bit simplistic, but the point I am trying to make is how our fears can trigger irrational behaviour to the point where you accept the insulting offer from the New York fund manager and sell your shares.

The stock market can sometimes be mistaken for a casino, particularly when shares prices are falling for no good reason – and it feels like you are losing all your money. When this happens, it is good to stop and remind yourself what a share really is: simply a part-ownership of a business that entitles you to a share in profits.

Investors spend much of their lives worrying about a repeat of the 1929 Black Monday crash when, we have been told, stockbrokers jumped from windows after losing everything. The reality is, you can never lose everything as the share market simply cannot go to zero.

Share prices behave completely irrationally in the short term, but it is not the share prices that are behaving irrationally, but the investors' behaviour that is irrational, resulting in the volatility of the share prices. The only way the stock market can go to zero is if you and I stop living, we stop earning and spending money. If we stop buying groceries, we stop using our cars, we stop eating out, we stop going to the doctor, we stop buying clothes, we stop using the internet, we stop using cellphones, we stop flying… Ultimately, if we stop breathing.

If this happens, then the shares we own in the businesses producing the goods and providing services we are using become worthless, because these businesses no longer have any profits for us to share. If you fear this may happen, then maybe you should think of selling your shares and building a bunker under your house.

Fortunately, we have history to remind us of our stupid behaviour. See the table below of past crisis returns for the S&P500 and beware the thinking, best encapsulated by Sir John Templeton when he said: "'This time is different' are among the most costly four words in market history." – *www.mwwealth.co.za*

S&P – PERFORMANCE SINCE GEOPOLITICAL EVENTS

Event	Date	Max Drawdown	12m Return
Iranian General Killed in Airstrike	03/01/2020	-0.7%	16.1%
Saudi Aramco Drone Strike	14/09/2019	-4.0%	11.1%
North Korea Missile Crisis	28/07/2017	-1.5%	14.0%
Bombing of Syria	07/04/2017	-1.2%	10.6%
Boston Marathon Bombing	15/04/2013	-3.0%	18.7%
London Subway Bombing	05/07/2005	0.0%	5.5%
Madrid Bombing	11/03/2004	-2.9%	8.4%
Invasion of Iraq	19/03/2003	-3.1%	27.0%
US Terrorist Attacks	11/09/2001	-11.6%	-16.8%
Iraq's Invasion of Kuwait	02/08/1990	-16.9%	10.2%
Reagan Shooting	30/03/1981	-0.3%	-16.4%
Yom Kippur War	06/10/1973	-0.6%	-43.2%
Munich Olympics	05/09/1972	-4.3%	-5.9%
Tet Offensive	30/01/1968	-6.0%	10.4%
Six-Day War	05/06/1967	-1.5%	13.5%
Gulf of Tinkin Incident	02/08/1964	-2.2%	2.7%
Kennedy Assassination	22/11/1963	-2.8%	23.9%
Cuban Missile Crisis	16/10/1962	-6.6%	27.8%
Suez Crisis	29/10/1956	-1.5%	-12.3%
Hungarian Uprising	23/10/1956	-0.8%	-11.7%
N Korea Invades S Korea	25/06/1950	-12.9%	11.2%
Pearl Harbour	07/12/1941	-19.8%	-0.2%
		Median -2.9%	Median 10.3%

Source: LPL Research, Stonehage Fleming, Jan 2022