Sweet Emotion?

The S&P is down nearly 20% since the 20th of September, turning a lovely and respectable 11.2% total return YTD into an excruciating 10.4% loss. In Europe, the pain has been even more severe. In the UK, the FTSE 100 is down 14.8% YTD; meanwhile the French CAC 40 is down 14.7%, and the German DAX 30 is down 21.9%.[1] There is no respite in Asia either; the Nikkei 225 in Japan is down 11.8% and the Shenzhen 300 in China is down 23.7%.

And the year isn't even over.


Not so sweet.

No matter what we pretend to ourselves, even for those of us with more than ten years of investing experience, this move is painful. It not only rekindles the fires that burnt in the pits of our stomachs in 2008 (or the dozens of earlier instances) it also elicits the same fears.[2]

For those less than ten years in, this is an unknown hell.

This move is even more difficult to withstand because we've been lulled into a very comfortable, blissful sleep over the decade. Over the previous nine years, total returns in the S&P 500 were positive <u>every single year</u>. Back in 2002, a 22.1% hit was preceded by an 11.9% hit in 2001, which itself was blunted by a 9.1% hit in 2000. Last year, in 2017, the single biggest peak-to-trough drawdown in the S&P 500 was just 2.2%.

It's no wonder that everyone is shell-shocked.

I'm not going to now suggest that everything is going to be okay, nor that the market will quickly recover. I'm not going to say that in all circumstances everyone should be opportunistic, nor am I going to suggest that we all become very defensive and go to cash. The truth of the matter is that I have no idea what is going to happen to the market today, tomorrow, or next year, or over the next decade.

But I've been in the industry long enough to know that the recipe for long-term investing success doesn't change when the market struggles. The key to long-term capital appreciation is to remain committed to an objective process, and to remain even-keeled throughout. That means throughout the days, months, quarters or years that the sun is shining on your investment theses; and throughout the periods where there is blinding darkness.

This doesn't mean that you shouldn't necessarily try to be opportunistic. We certainly are at our firm. But our excitement is confined to rare individual stories where we believe that idiosyncratic factors will ultimately dominate the fundamental story, and where Mr. Market is either temporarily disagreeing - or more likely, ignoring - our thesis, or briefly (we hope) overemphasizing noisy, inconsequential datapoints.

We do not, however, get excited because of some sense or notion that the equity markets are oversold, or that the outperformance of the US over European markets looks set to flip, or that the market's appetite for value is probably closer to its nadir than its zenith. Sure, each of those things would surely be welcomed by ourselves and our investors, but the market doesn't know that, and the market doesn't care. And while understanding behavioural finance *may* help us to generate long-term excess returns by capitalising on under and overreaction in specific, idiosyncratic instances, I can promise that neither Dick Thaler nor Bob Shiller nor any other respectable expert in the field would profess to have a clue about where equity markets will go over the next few years. We sure don't.

Can we recognize narratives? Sometimes. Will that help us to know when short-term narratives might change? Unlikely. Will they eventually change? Yes. Are fundamentals and long-term narratives ultimately joined at the hip? We think so, and so did Ben Graham. So we're going to stick to the fundamentals. You probably should too.

And if you really think you can call markets, dream on.[3]

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[1] These are all USD total returns.
[2] Sweet Emotion, Toys in the Attic, Aerosmith, Columbia Records (1975)
[3] Dream On, Aerosmith, Aerosmith, Columbia Records (1973)