

Keeping Calm and Carrying On

October unleashed a storm upon financial markets. Here in Europe, we hadn't had one since Brexit, but had many before then, and will surely have many more. Bad weather is a feature of investing, and as the stewards of long-term capital, we need to balance action and inaction during these bouts of market turmoil. In some cases, we need to seek shelter, but in others we must ask ourselves if the weathermen are getting a little too excited.¹

In other words, we should not blindly or naïvely sit tight, assuming that the market is 100% wrong about everything; nor should we let emotions dominate our decision-making, nor deviate from our core principles. From an individual stock perspective, we should try our best to never panic about any position. In fact, when we feel like we are approaching our own maximum fear, we should remind ourselves that Mr. Market probably feels even worse. And since he is the one making the price, we need to consider what he might be baking in. At the same time, we must be prepared to contemplate that our initial hypothesis might be more tested than we might have expected, or even be wrong. There is no value in remaining steadfast when the facts change.

We also want to be opportunistic. This is a long game, and if we notice an unwarranted idiosyncratic move (or lack thereof) that tilts the risk/reward equation further in our direction, we should take advantage of that. As we have discussed in other pieces, the indiscreet machine-led behaviour of the machine-reading algo of machine-generated headlines can open up tremendous windows of silliness. Our view – which is contrary to recently-emerged popular opinion – is that these judgment-lacking dumb robots aren't bad for the alpha business, they are good – as long as we exercise objective judgment in the process.

Moreover, from a portfolio perspective, making top-down calls is not a part of our process, nor is it essential. While some of our companies are more affected by macroeconomic fundamentals than others, our job is to be on top of all developments (macro and micro), and objectively model the impact of high or low oil prices, Chinese demand, and global trade wars as they happen. We then task ourselves to discover if there are any opportunities to take advantage of Mr Market when he under or over-extrapolates fundamental datapoints due to his top-down view; a view that almost certainly is poisoned by emotion.



Look through the storm, but remember that *it is a storm*.

For what it is worth, we have all known about globally-coordinated central bank intervention propping up asset prices, and we've known about bombastic political tirades, retaliatory tariffs, and ongoing trade wars. We've also known about the spectre of rising interest rates. We've known about these things for many months, even years. The only new information in the first three weeks of October was that the market decided it wanted to care. Will it care even more tomorrow? Will it care at all next year? **We do not know. No one knows.**

At the lows last month, the S&P 500 was down 10.6%. It bounced from those lows, but still closed off 6.9% for the month of October, while the Eurostoxx 600 was down 5.5%. These not only might have been the right moves, but markets might be down *another* 5-7% in the next month or two. They also might not. They might be up 5-7%, or half that, or twice that. **Again, we don't know, and no one knows.**

But the market sometimes thinks it knows. As such, we should all prepare ourselves for the rising chorus of "the market doesn't care about fundamentals". This siren song is tough for many to resist, and leads to panic selling (often called "risk management"). This is a test that the consensus investor fails every single time. When Mr. Market throws in the towel on stock-picking, this is exactly the time when stock-picking can shine.

With all this - and this is perhaps particularly important to do in times like these - we must all remind ourselves that **the fundamentals are actually the only things that matter**. Narratives are important indeed, especially in the short and intermediate terms², but at the end of the day (or should I say, decade), stocks that beat expectations go up, and stocks that miss them go down.

¹ Kind of like this guy: https://www.youtube.com/watch?v=r_WcJ3t3xP4

² Ben Hunt at Epsilon Theory believes that narratives are the only thing that matter, even in the long-run; but were going to go with a different Ben here (Graham) and concede that they are indeed voting machines in the short and intermediate run, but weighing machines in the long term. Fundamentals and narratives are ultimately joined at the hip.

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