

THE SAD TIMES

MARKETS ARE UP, THIS IS NOT GOOD



THESE ARE THE TIMES
WHEN THE MARKET IS UP
AND THE NEWS IS BAD
AND THE INVESTOR IS
CONFUSED. THIS IS THE
SAD TIMES. THE MARKET
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Bubbles & Crashes & Bears, Oh My

By Daniel Babington, Portfolio Manager at TAM Asset Management

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Investing in financial markets requires discernment, but there is a fine line between discernment and cynicism. In my view, both the financial and mainstream commentariat spends much of its time in the latter camp. Never more so than this year as we mull over AI bubbles and all-time highs in stock markets. As our valued clients, it is critical to be armed with the know-how to pull out the insightful and ignore the inciteful. This note is written to explain why the media can be so negative, and what the surprising data tells us about the state of markets.

We weren't designed for this

The uncomfortable truth of investing is that every participant in the stock market is aiming to make effective capital allocation decisions with the same instincts developed purely to survive on the savanna. The human brain has not even begun to adapt to our 21st century knowledge economy, because it hasn't had the time. If we trace back to the earliest known evidence of the genus Homo (of which sapiens are the only iteration to survive) and condense this timeline into a calendar year, the London Stock Exchange was created on New Year's Eve just after the clock strikes 11pm. While the first Bloomberg Terminal, then called the 'Market Master' wasn't created until 11 minutes to midnight. When you look through this frame, it is clear the biases needed to survive could easily muddy our modern investment strategy. The most apposite bias is that we are innately fearful. This is a survival mechanism that evolved to protect us from ancestral threats like predators, social exclusion, and disease.

Beware celebrity forecasters

Due to this bias, bad news sells as it grabs our attention and rouses these well-developed neural pathways. There are many ways journalists can use this knowledge to generate clicks. One I have observed recently is to quote an investor who correctly foresaw a previous stock market crash, who is again prophesying an impending crash. Such exclusives are enticing as this expert has a tangible track record of foresight, verging on crystal-ball-level mystique. There is no one better to grab the attention of the reader.

One such is Michael Burry, prickly protagonist in the Hollywood blockbuster 'The Big Short'. His success in identifying the 2008 financial crisis was remarkable and incredibly brave at a time when the whole financial sector was unwilling to listen. His handle on X (formerly Twitter) is 'Cassandra'. A play on a character of Greek mythology, a Trojan princess blessed with prophetic gifts by the god Apollo, but who was cursed so that her warnings were never believed. Great marketing. If we view 2008 in a vacuum, Burry is a mastermind investor. If we consider his prediction of an impending 'financial meltdown' in 2017, a 'market bubble' in 2019, then if we mirrored his shorts in 2020 and 2021, acted on his calls of a 'crash' in early 2021, then again on the 'mother of all crashes' in mid '21, 'more bank failures' in '22, an imminent recession in early '23 and mirrored his S&P 500 shorts in late 2023, you would have missed an incredible run for stocks over the last eight years. This isn't an attack on Michael Burry, who remains an intelligent investor but rather to remind that no one has a crystal ball, and if someone makes a career off a big contrarian call, they are highly likely to endeavour to repeat it.

In fact, beware all forecasters

The media machine requires 24-hour content and those who are open to making bombastic forecasts are shuffled to the front of the pack. Survivorship bias causes us to overestimate the odds of success because just as we have seen with Mr. Burry, the human psyche is more susceptible to remembering the one prescient forecast over a pile of assertions which proved incorrect. In fact, in a landmark 20-year study, social scientist Philip Tetlock collated and analysed c.28,000 forecasts on political and economic events made by 284 experts. He found that when you do consider all forecasts, the average predictions were only slightly more accurate than chance, or to put it crudely, a 'dart-throwing chimpanzee'. It is accepted that it is impossible to predict the future, but when it is framed as a 'forecast' it can slip through our defences. A technique that is prudent is an approach to investing that identifies, analyses, and prepares for different scenarios through a relative value lens, without putting all the eggs in one basket. Further to this, much of TAM's work is grounded in identifying the active managers who have a rigorous process, steeped in experience, using fundamental, evidence-based analysis, rather than relying on grand forecasts.

Discernment, not cynicism

This note sits amid a cacophony of calls of an AI bubble. If one approaches the topic with discernment rather than cynicism, then there is room for a healthy debate at these valuations. It is arguable that there are pockets of froth in the sector. But when posed with a new technology that will touch every corner of the economy, it is worth assessing whether your media diet and your innate biases are playing an outsized role in your assessment. I urge you to read my colleague Francis' note on chips to understand what is happening under the surface. The companioning headline to this of late is that we are at all-time highs in a selection of stock markets. This is a certainty that I cannot debate, but like all topics raised in this note, it may benefit from a reframe. Analysis by Schroders found that since 1926, US large cap stocks have ended a month at an all-time high 31% of the time. And although these moments may seem a comfortable time to move to cash, the last 100 years of analysis shows investing at this very moment saw a one-year return actually above the average while three- and five-year returns were not compromised versus the average of investing at any other time. Whereas switching to cash each time for the month thereafter ended up eroding 90% of total market gains in this 100-year period. In other words, conventional wisdom in markets doesn't always stand up to scrutiny. With the benefit of hindsight, an all-time high may prove to be the best buying opportunity you ever get.

Why markets don't always make sense

If this all seems counterintuitive, you are not alone. But the negativity of the press is fortunately less present in stock markets. Since 1926, the US stock market has experienced positive returns 75% of the time on any one-year basis and as much as 95% of the time on any 10-year basis. Plainly, being fully invested in the equity market, as much as your risk tolerance dictates, remains prudent over the long term. Why? The oversimplification is that the unrelenting force of human ingenuity eventually translates to greater company earnings which ultimately, broadly translates to greater company share prices. Easy. Sadly, in the short and medium term, it is much trickier. The seemingly wild unpredictability of markets is defined best perhaps by Professor Stephen Kellert's 'Chaos Theory'. Broadly, markets are 'nonlinear', meaning the smallest of inputs can create the largest of reactions. They are dynamic, in the sense each factor has varying effects on other factors and lastly, they are aperiodic, meaning they never repeat the same way twice.

Sensibility, not sensationalism

Be wary of sensationalism on both sides. Things are never as bad as we fear yet seldom as good as we hope. I have painted the optimist's picture to challenge the pessimistic prose we are all subject to. In reality, each person has differing risk appetites, timeframes and financial goals and, in the end, each financial journey is unique. While it is comforting to know that all is not as bad as we are told, there are of course times when newspaper articles will have proved correct and instances where selling will, for potentially long periods of time, look prudent. It is up to TAM to debate and collate all sources of information and build portfolios aligned to our clients' goals and the best opportunities we see in markets. We want to provide our clients with a smooth journey across the short, medium and long term and have a plethora of tools at our exposure to utilise when things move too far too fast. These include gold, alternative strategies and instruments that benefit from volatility. We champion diversification above everything, and we see fantastic opportunities around the world which behave differently to the companies driving artificial intelligence growth in the US and beyond. We have the knowledge and experience to curate our media diets to remove emotion and stick to the facts, which means we can approach markets with discernment, not cynicism.

If you would like to speak with us about anything in this note, or to discuss our discretionary investment management services in general, please get in touch with our UK business development manager David Terry today.



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