Contact Asset Management

INSIGHTS

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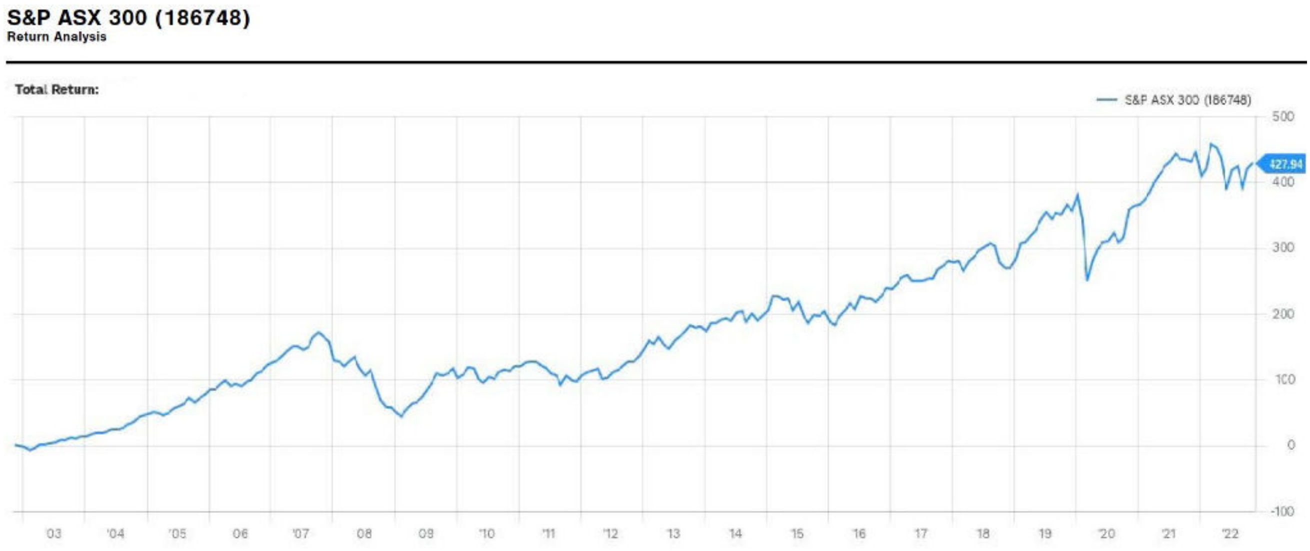
Time in the market, not market timing

Contact Asset Management believe that sound fundamental analysis that values high Return on Capital, robust Balance Sheets, sustainable dividend profiles, honest and aligned management teams and appropriate ESG credentials, sharpens our scope to a universe of quality businesses that we can own through the cycle.

Markets are cyclical and investors have been reminded of this truism since March 2020. Yet recent behaviour illustrates that many participants continue to extrapolate the current settings and now-cast into the future. Drawdowns do happen, but they aren’t fatal. That is, if one invests in quality businesses that can withstand challenging macro conditions, and not capitulate to the folly that you can in fact time the market. This is fool’s gold.

We believe that to compound your returns, it is time in the market, not market timing that matters. The S&P/ASX 300 Accumulation Index has delivered a compound annual growth rate of 8.7% over a 20-year period or a cumulative 428% Total Return for the period if the investor maintained continuous, uninterrupted exposure to Australian Equities.

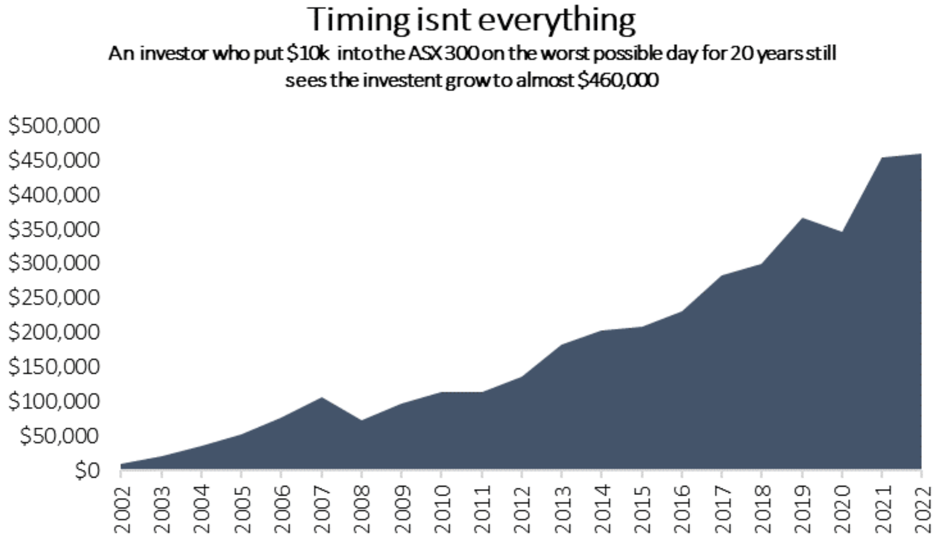
Total return of S&P/ASX 300 Accumulation Index over 20 years



Source: FactSet

Interestingly, between 80-90% of the investment return in stocks occurs during only 2-7% of the time. The other 93% of the time, returns have been minuscule or negative[1]. It is remarkable to fathom that just 2-7% of the time could provide the vast sum of an investment return. This made us wonder then if an investor with atrocious timing puts $10,000 into the ASX 300 on the worst possible day each year for 20 years what would they return? This hapless investor would have accumulated a tidy sum of $459,118. The conclusion: maintaining an exposure to Australian Equities, even when poorly executed, can provide better outcomes than sitting idle on the sidelines.

[1] Source: Christopher H. Browne. The Little Book of Value Investing. 2007. John Wiley & Sons Inc..



Source: FactSet, Contact Asset Management

The chart below shows the reliability of market shocks or black swan events that can impact equity markets. Again, this highlights the danger in trying to time the market. If one withdrew from the equity market and went to full allocation of cash for fear of further mark to market losses during any of these events, an opportunity to recover and capture capital growth made during the ensuing rally would be missed.

Long term performance of the market notwithstanding major "shocks"

Source: MSCI

The power of allowing compounding to do its work was eloquently put by U.S. investor Chuck Akre's firm Akre Capital Management within a white paper, *"You are given the choice between 2 sums of money: 1 million dollars or 1 cent that will double every day for 30 days. Which should you choose? Here are a couple hints. The 1 cent coin that doubles daily would be worth $1.28 after the 1st week. After the 2nd week, it would be worth $163.84. You will probably reason that the 1 cent would be worth more than the 1 million dollars. By just how much might surprise you. It turns out that after doubling 30 times, the 1 cent would be worth $10,737,418.24! But you would have been better off taking the 1 million dollars until the 27th day. But in* *those final 4 days, the value of the 1 cent increases from less than $700,000 to more than $10.7 million. Patience and a long-term perspective are required to give the power of compounding an opportunity to do its magic."* Magic indeed.

The field of Behavioural Finance has penned volumes on the power and influence that herd mentality and group think can have over public markets. It is this phenomenon perhaps as to why when markets are seemingly on an unstoppable march higher there are ample buyers and limited sellers but when the market is in bear territory, regardless of fundamental valuations, these same buyers are exiting. Turning paper losses into permanent capital destruction.

This same phenomenon explains why it's almost impossible to bring an IPO to market near the bottom of a cycle, an investment banker's nightmare. But as a cycle grows fuller, the number, size, and valuations of IPO's explode. Warren Buffet relays a story in the Berkshire Hathaway 1985 Annual Letter to Shareholders that Ben Graham once illustrated why stock market participants behave as they do.

> 'An oil prospector, moving to his heavenly reward, was met by St. Peter with bad news. *"You're qualified for residence", said St. Peter, "but, as you can see, the compound reserved for oil men is packed. There's no way to squeeze you in." After thinking a moment, the prospector asked if he might say just 4 words to the present occupants. That seemed harmless to St. Peter, so the prospector cupped his hands and yelled, "Oil discovered in hell!" Immediately the gate to the compound opened and all of the oil men marched out to head for the nether regions. Impressed, St. Peter invited the prospector to move in and make himself comfortable. The prospector paused. "No," he said, "I think I'll go along with the rest them. There might be some truth to that rumour after all."*

During these volatile periods we find that markets can be particularly irrational, creating opportunities for us as long-term investors. In this market we continue to find quality businesses representing good value.

Its been an interesting 2022 to date, and like so many periods we've seen before, this year reinforces an important lesson – *stay the course and invest for the long term*. We are optimistic that sound fundamental analysis that values high Return on Capital, robust Balance Sheets, sustainable dividend profiles, honest and aligned management teams and appropriate ESG credentials, sharpens our scope to a universe of quality businesses that we can own through the cycle. We remain convinced that in the end optimism rules and opportunities never cease.

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