THE DANA VIEWPOINT

*November 26, 2019*
*Dow: 28,122*

# Lessons Learned

Usually, the lessons that will help us most as investors are the hardest to learn and practice because most useful lessons pertaining to investments are counterintuitive. One is that "group decisions" are many times poor and late. Both individual securities and active investment strategies go through cycles where they outperform and underperform. It is difficult to step up and purchase a security after a period of underperformance, and it is easy to come up with many justifications to purchase a security after a period of outperformance. Buy high and sell low is the rule followed by most inexperienced, emotional investors, trend followers, and pure momentum investors. This is not a way to beat the market. Some degree of contrarianism is essential for significant success. After all, the market itself is a distillation of the groupthink of all the participants in the market. The same biases apply to investment strategy selection. It is easy to hire a manager or strategy after a period of outperformance, but few would recommend hiring a manager or strategy after a period of underperformance. The latter would have to study why the manager or strategy generated the performance it did, and thus involve a deeper understanding than just a cursory review and recommendation based on performance, which can be complicated.

Some believe timing the market is a key to success, but we have not seen any entity succeed at this long term. Even Warren Buffet does not try and time the market. He may have large cash positions, but those are driven by his ability to find discrete investments that meet all of his high hurdles for purchase, not by broad market valuations. Once he establishes a holding, he normally holds it for decades, sometimes through long periods of underperformance. That approach may be extreme, but it has worked for him. We believe in maintaining diversification while being fully invested in all of our investment strategies. We believe the risk profile of every client may differ, and that adjustments should be made outside of the actual strategy. Another lesson we have learned through market cycles is that risk should be added at market lows. This sounds extreme, but it is just the converse of the truism that risk should be reduced at market highs, a notion that few would argue against. Increasing risk in times of stress and uncertainty is also a strategy employed by Buffet, as when he deployed large amounts of capital in 2008 when the market was in turmoil.

If these principles sound contrarian, they are. One way to understand contrarian principles is to think of them as beliefs that sound totally reasonable in the abstract, but are extremely difficult to employ in the heat of the moment. There have been multiple causes of unease recently: in mid-August, the market was disappointed with the quarter point the Fed cut from interest rates at the end of July, earnings in the third quarter were expected to be flat or lower, slower growth and industrial production were expected through the end of the year,

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the trade deal with China continued to be on again or off again, the specter of impeachment and a trial in the Senate became a real possibility, and the market fell six percent in just the first two weeks of August. None of these concerns have gone away in the last three months, and most have worsened or become more persistent. Nevertheless, the S&P 500 is up over 10% in the last four months – not the outcome many would have predicted. Hedge fund managers, the supposed smart money, have been forced to deploy some of their high cash positions to chase the market, driving the rally to new highs. No, we don't know how long the rally will continue, but we will ensure that our portfolios will participate by being fully invested, yet diligent in looking for opportunities to improve our holdings.

In bonds, investors have been rewarded for taking more risk and holding longer bonds. That has been true for current holders who have enjoyed price gains as well as income in this bull market for bonds. That will not necessarily be true for investors from this point forward. Credit spreads have remained tight and capital gains for the most part have been preserved, but there is no guarantee this will hold into the future. It looks like yields have hit their low for this year and have begun to head upwards after the last Fed easing. Keep in mind that the Fed wants to see longer rates higher than short rates, even though they don't often say it publicly. The yield curve is no longer inverted and the Fed can breathe a sigh of relief and spend some time on the economic sidelines instead of in the spotlight. Some contrarians may have missed the rally as they held shorter duration and higher quality securities during this bond bull market, but they are being rewarded most recently.

**Please share our best wishes for a happy and restful Thanksgiving holiday with your families.**

**Random Thought for November 2019:** "As we express our gratitude, we must never forget that the highest appreciation is not to utter words, but to live by them."

John Fitzgerald Kennedy



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