Insights

INVESTING THROUGH A MARKET CORRECTION

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The key to investing before, during, and after a market correction or a recession is to keep an eye on the big picture, rather than trying to time your way in and out. Even though there is a lot of historical evidence for the cyclical nature of certain investments, the fact of the matter is that timing such cycles is beyond the scope of any investor and I do include the institutional investor as well.

Believe it or not emotional decision making is the default option for our brains. However, we all like to think that we only use logic to arrive at our decisions. In fact without emotion we would be largely incapable of making any decisions, but all too often we allow our emotions to rule unchecked.

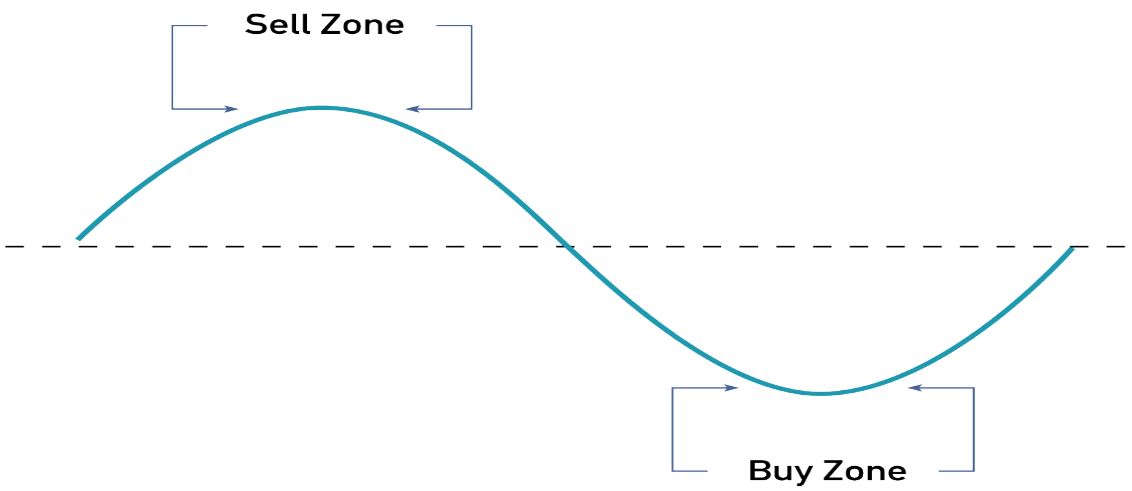
Neuroscientists have recently uncovered two particular traits of significance to investors. The first is that we are hard-wired for the short term. We tend to find the chance of short-term gains very attractive. They appear to stimulate the emotional centres of the brain and release dopamine. This makes us feel confident, stimulated and generally good about ourselves. Essentially we are addicted to the positive upside of investing and continuously grave it.

The second is that we appear to be hard-wired to herd. The pain of social exclusion (i.e. betting against everyone else) is felt in exactly the same parts of the brain that feel real physical pain. So pursing contrarian strategies is a little bit like having your arm broken on a regular basis.

What is Investing?

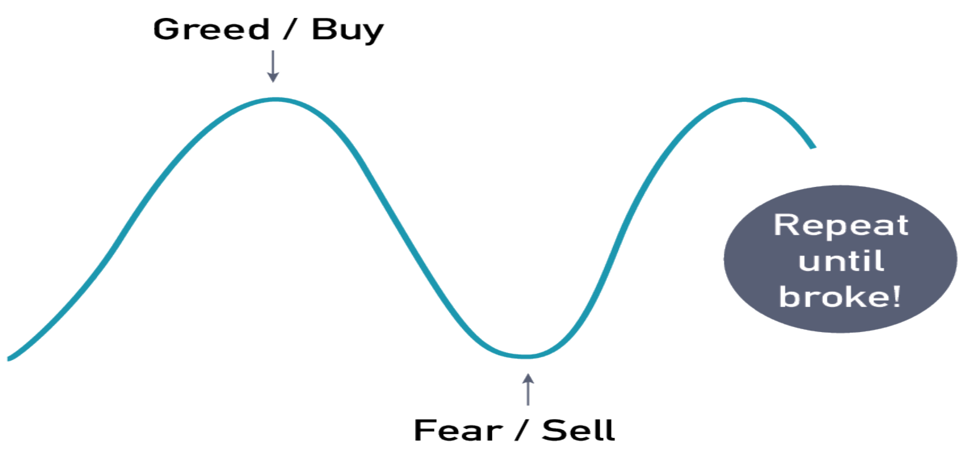
Let's look at investing at a very basic level. As demonstrated by the graph below the main objective is to buy assets at their cheapest and sell when they reach optimum value. A simple concept you must agree but reality is very different!

Chart 1: Optimal Investment Timing



As mentioned the human is hard wired for the short term and the problem now is the investor will make poor decisions that has a detrimental effect on his investment outcomes. Essentially he potentially buys into his investments at the wrong time and sells them at the worst possible time.

Chart 2: The Human Effect



However, there's no need to be discouraged, because there are many ways that an ordinary person can invest to protect and profit during these challenging times. Difficult times often coincide with the best investment and buying opportunities.

One of the most successful investors in the world is Mr Warren Buffet, the CEO of Berkshire Hathaway. He has a lot of advice for investors and it would be remiss of us to ignore his guidance. While he is generally a value investor, he's also an avid supporter of buy-and-hold investing. In other words he is not a believer of jumping in and out of the markets in an attempt to outsmart others. He believes if you are not willing to hold an investment for at least 10 years you should not hold the investment. Consider that in terms of your retirement planning, these types of accounts have long time horizons.

But a more important piece of guidance given the environment we find ourselves in today is his attitude towards as and when to invest. While market corrections can be dramatic and seem quite daunting they do create an enormous opportunity. Again quoting Mr. Buffet;

"Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can't buy what is popular and do well."

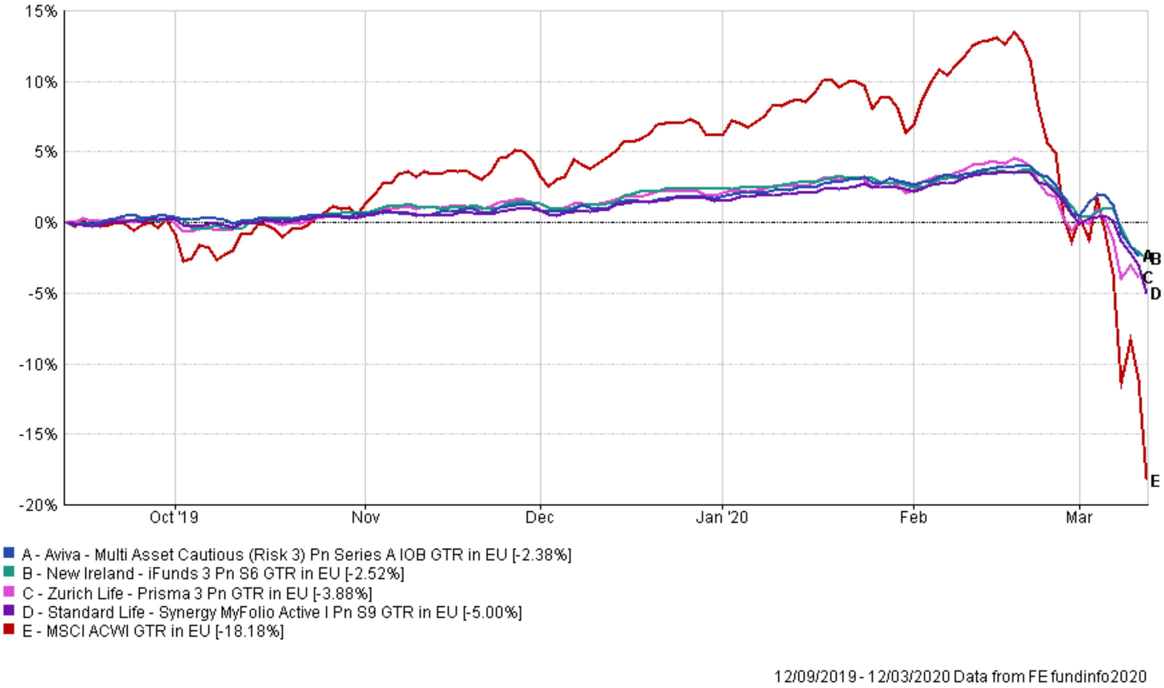
This concept is clearly demonstrated in chart 2 above.

So what is our advice?

First of all we need to look at our main positions. Thomond Asset Management while encouraging clients to fully invest we have maintained quite a cautious and defensive position over the last number of years. The main reason being we believed we were heading towards the upper end of the cycle. This typically positioned the majority of our clients in an ESMA 3[1] portfolio, demonstrated below by using a sample of multi-asset funds from various fund managers. The implication of this is that while the markets have experienced a negative top bottom drawdown of approximately 30%, the majority of our portfolios have only experienced a fraction of that negativity.

[1] https://www.esma.europa.eu/

Graph 1.



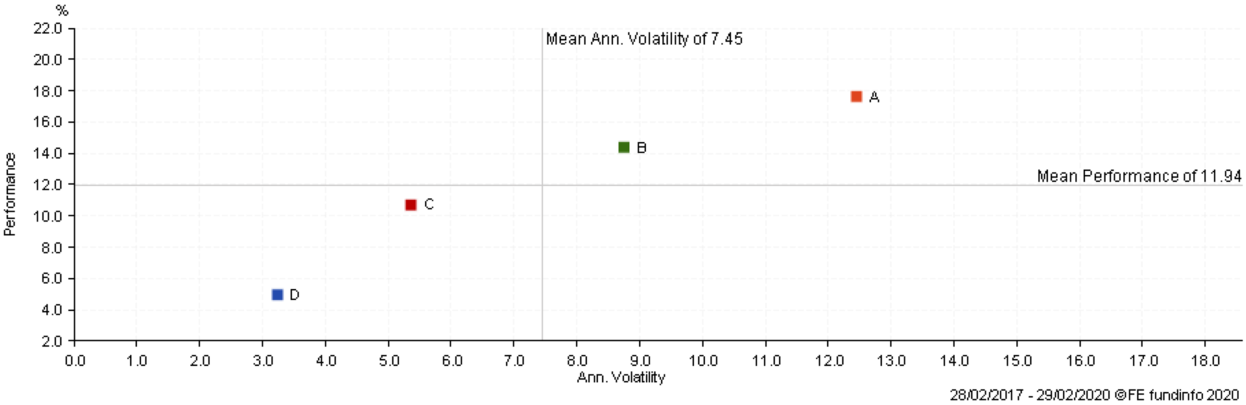
But where does that leave investors today and what could we do to benefit ourselves in the longer term?

As we see it there are 2 strategies that need to be considered. One refers to the assets that are already invested and the other involves future savings or pension contributions.

Strategy One: Risk Step Up

Consider the chart below. What it demonstrates is the reward potential of moving your portfolio along the volatility scale. This means you are increasing your allocation to growth assets as you move your portfolio up and to the right. This allows you to increase your exposure to more growth assets and as the markets begin the recovery cycle you will benefit from a greater exposure to growth assets.

Graph 2: Risk Versus Reward



Key	Name	Performance	Annualised Volatility
A	New Ireland - iFunds Equities S6 GTR in EU	17.65	12.45
B	New Ireland - iFunds 5 S6 GTR in EU	14.41	8.75
C	New Ireland - iFunds 4 S6 GTR in EU	10.71	5.36
D	New Ireland - iFunds 3 S6 GTR in EU	4.97	3.24

Of course this requires careful consideration depending on your own personal circumstances but speaking to your financial adviser is the essential first step.

Strategy Two: Euro Cost Averaging (Regular Contributions)

Euro Cost Averaging (ECA) is an approach that is often advised in situations where investors wish to build up a portfolio over time. It is also a useful approach to avoid the challenges faced by investors when attempting to time the markets. Most clients, without realising it are availing of this strategy when they are contributing to a savings or pension portfolio each month.

Our guidance would be to increase your monthly purchasing of risk assets. Maximise this opportunity to acquire growth assets particularly as they have become notably less expensive. The longer term effect is that you will acquire more units at a cheaper price and when the markets recover the value of your portfolio with rise much faster.

You can achieve this by re-allocating to a more growth oriented fund or if already acquiring units in an equity based fund perhaps increasing the amount you are contributing each month.

As above, this requires careful consideration depending on your own personal circumstances but speaking to your financial adviser is the essential first step.

Always seek the advice and support of your investment adviser before making any significant changes to your investment positions.

This outlook and commentary does not constitute an offer and should not be taken as a recommendation from the author or Thomond Asset Management. Advice should always be sought from an appropriately qualified professional.

WARNINGS

1. The income you get from an investment may go down as well as up.
2. The value of your investment may go down as well as up.
3. Benefits may be affected by changes in currency exchange rates.
4. Past performance is not a reliable guide to future performance.

REGULATORY STATUS

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