October 2024 Market Commentary

Just a Little Patience

https://www.youtube.com/watch?v=ErvgV4P6Fzc

Take it slow it will work itself out fine
All we need is just a little patience

When I was a young man working on my MBA back in the early 1980's, I came across an article published in *The Financial Analysts Journal* in 1975 titled **"The Loser's Game"** by Charles D. Ellis. This article went on to become the very popular book, ***Winning the Loser's Game***. Little did I know it at the time, but it was a seminal moment in my investment management journey.

In a nutshell, "The Loser's Game" professes:

- That prior to the 1960's the stock market was dominated by individual investors, and the few professional investors found it relatively easy to exploit market inefficiencies.
- As the market evolved and became dominated by professional investors (now over 90%) and computers, inefficiencies were competed away and outperformance was rare and fleeting.
- Ellis introduced us to the "loser's" game: a game played where the person who wins is the one who makes the fewest mistakes.

- The best analogy was amateur tennis, where over 80% of the points are lost: the ball is either hit into the net or out-of-bounds. The winner is the player who makes the fewest mistakes.
- Ellis goes on to explain that the three biggest bets that investors can make versus the market are:
    1. Market timing. Don't do it. The market index is always fully invested, and you can't predict the future.
    2. Sector bets. The market is sector agnostic. Weights are determined by performance.
    3. Individual stock bets. Possibly an area where investors can add value through analysis, and more importantly patience.

The reason for this little walk down memory lane was Roger Federer's recent commencement address at Dartmouth. Federer, arguably one of the greatest tennis players of all time, highlighted a fascinating statistic. *"In the 1,526 singles matches I played in my career, I won almost 80% of those matches. Now I have a question for all of you. What percentage of the points do you think I won in those matches? … **Only 54%!**"*

Amazingly, a man who won 20 Grand Slams, only had a 4% edge over his opponents.

Federer went on to explain how he won at the loser's game. His key to success was not to fixate on individual points, but to play the long game of perseverance and survival. He won by being patient.

Diving a little deeper into the numbers we see that Federer performed better in five-set matches than he did in three-set matches. In other words, the longer the match the more his strategy of making fewer mistakes would pan out.

Matches	%
Matches Played	429
Matches Won	369
Matches Won %	86.0%

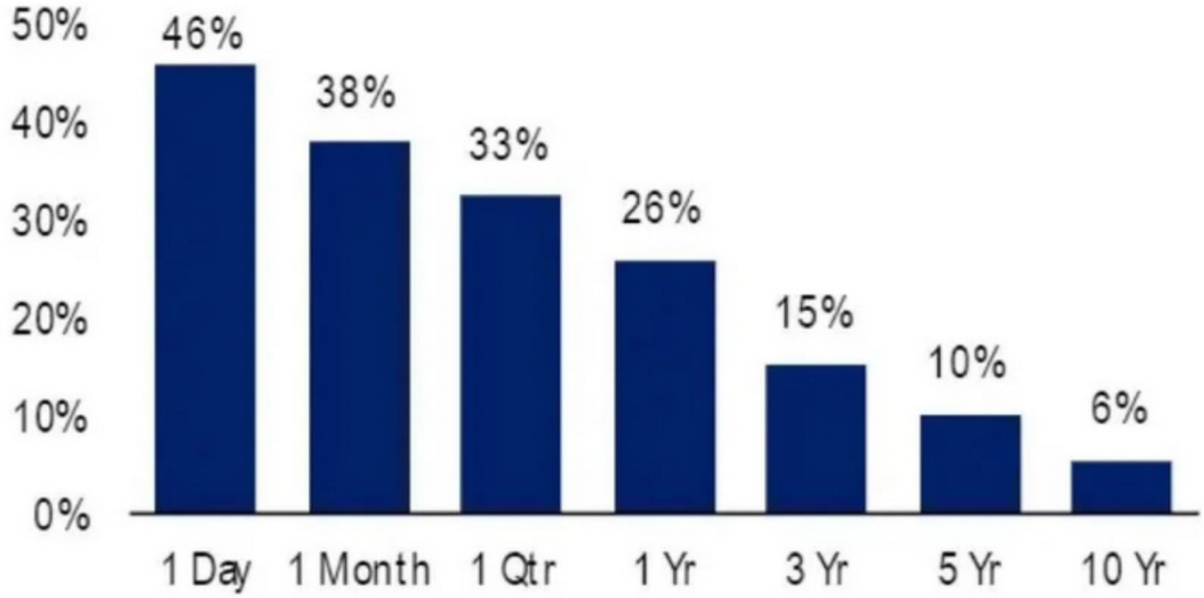
Matches	%
Matches Played	76
Matches Won	59
Matches Won %	77.6%

Source: Ultimate Tennis Statistics

Investing is surprisingly similar. On any given day the S&P 500 is up 54% of the time (1929-2023). But, if we expand that to a year, you made money 74% of the time, and 10 years, you made money 94% of the time.

As Warren Buffett famously said, *"The stock market is a mechanism for transferring wealth from the impatient to the patient."*

Probability of negative returns, based on S&P 500 total returns from 1929-2/28/2023



Source: S&P, Bloomberg, BofA US Equity & Quant Strategy

Patience is the individual investor's edge over the professional. Almost all professional investors are measured on a yearly, quarterly, monthly, and even daily basis. Their bosses, and their clients, are constantly looking at how they are performing versus their peers or a benchmark. They are under incredible pressure to focus on individual points, not the long game.

This has been one of Warren Buffett's biggest advantages. By structuring his investment vehicle inside of the insurance company Berkshire Hathaway, he has been allowed to play the long game: staying focused on making fewer mistakes over time, versus other professionals focused on trying to hit winners every day.

I can certainly attest to this. When I was a young mutual fund manager, I was under immense pressure to perform daily. This pressure causes you to try and hit winners, and when you hit it out-of-bounds you double down and try and hit another winner. It is a brutal game, and it's why about 80% of mutual funds fail to beat their benchmarks.

Today, when I invest my own money, I take a much longer-term view. My ultimate goal is to have a portfolio concentrated in a few stocks that I feel good about for decades, totally aware of the fact that they will have periods of under-performance, but also that over the long run they will outperform their peers. Patience is our superpower.

As Federer says, "The best in the world are not the best because they win every point…it's because they know they'll lose…again and again…and have learned to deal with it. They cry, smile, move on. They adapt and grow, work harder and smarter, and most importantly stay patient."

Said "Woman, take it slow and it'll work itself our fine"

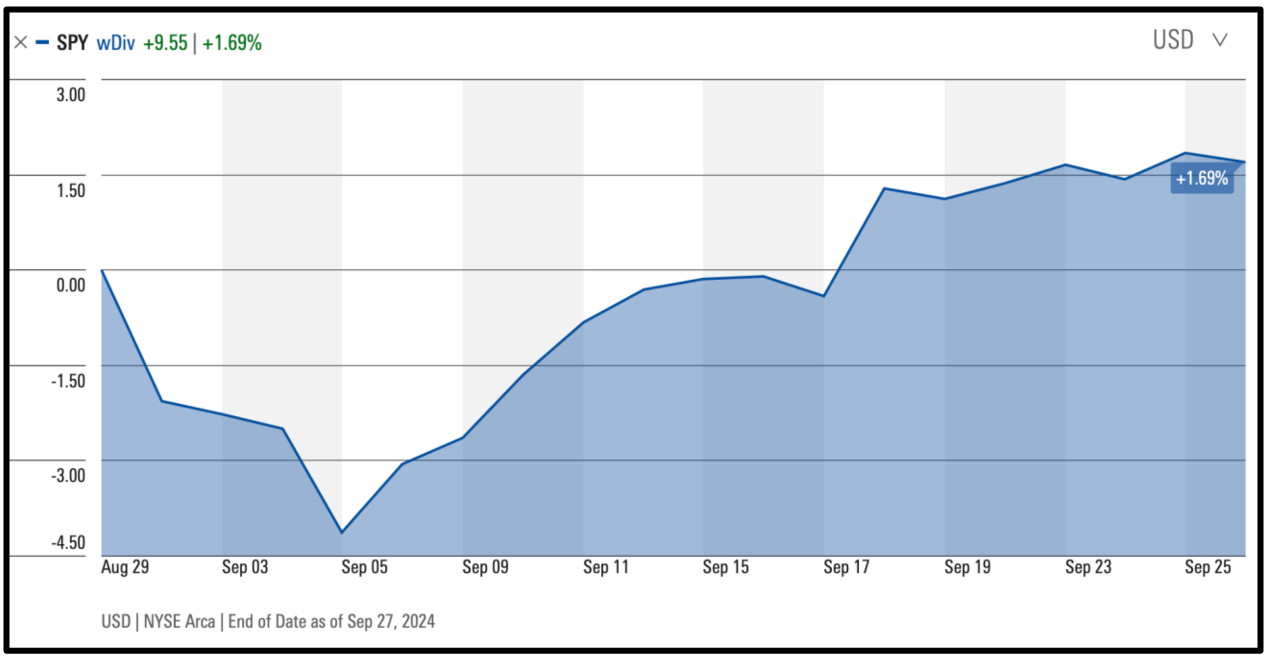
All we need is just a little patience

Said "Sugar, make it slow and we'll come together fine"

All we need is just a little patience

<u>Market Commentary:</u>

For those focused on the short-term, September offered up enough volatility to drive them crazy. First, we started the month with the worst week of the year, followed immediately by the best week of the year. Then the much-anticipated Fed meeting, with a slightly surprising 0.50% rate cut, the first cut since March 2020, which led the market climbing to record highs.



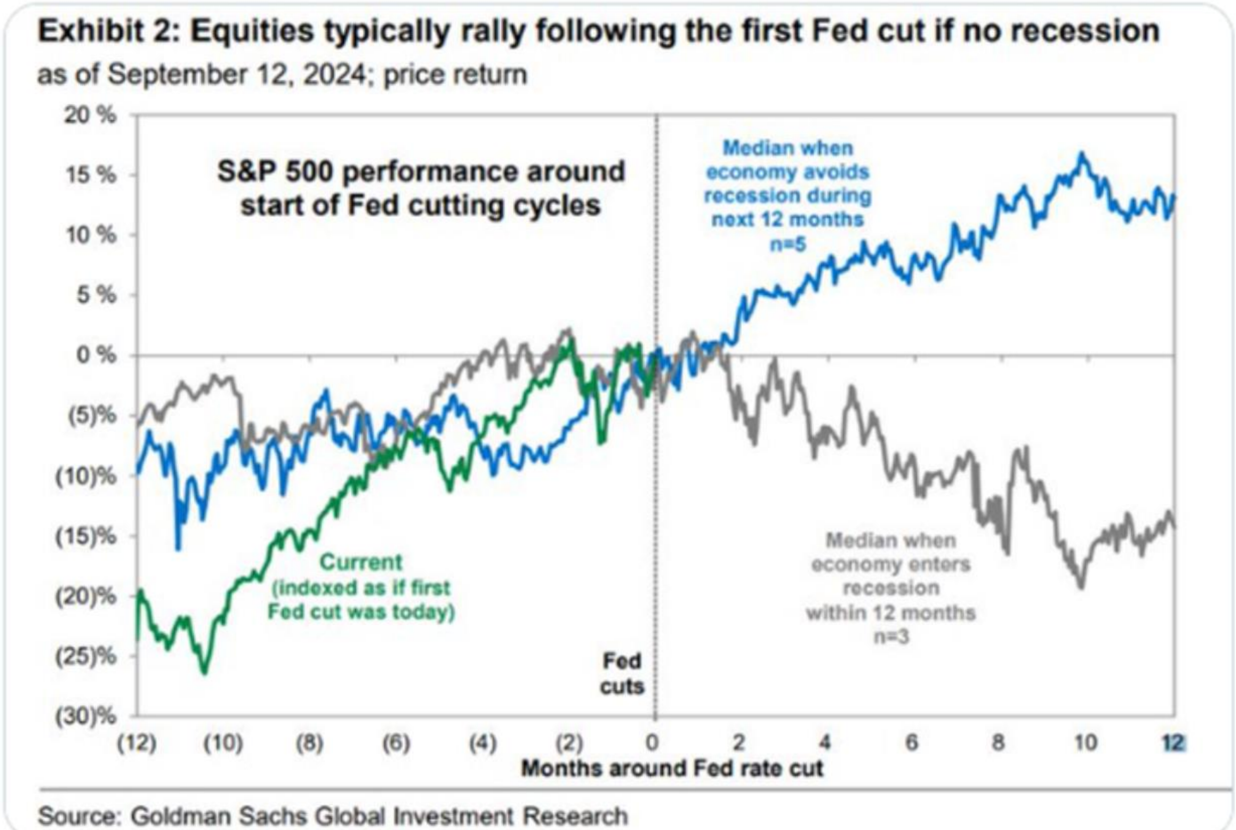
Taking a longer-term view, the most important thing to remember is that earnings drive equity returns. As the economy grows, earnings grow. And as earnings grow, stocks appreciate.

As the chart above shows, stocks have had a pretty impressive climb from 1990 to today, but there were also some pronounced declines that coincided with earnings declines, which not surprisingly coincided with recessions.

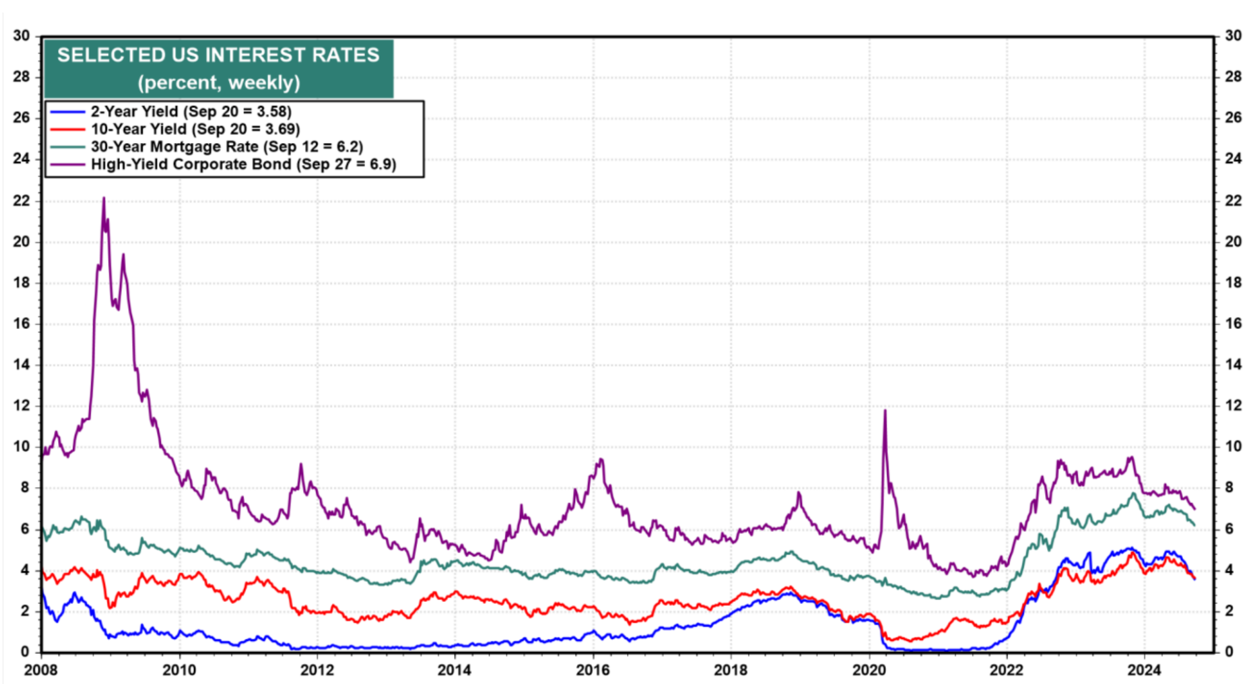
The trillion-dollar question now is, is the Fed cutting interest rates because they foresee an economic recession on the horizon, or are they cutting rates because they have simply been too high for too long? Nobody knows, including the Fed.

The chart below shows that what really matters for stocks after a rate cut is what happens to the economy. If we manage to avoid a recession in the next twelve months, stocks have rallied about 15% historically. But if we slip into a recession over the next twelve months, stocks have fallen about 15%.

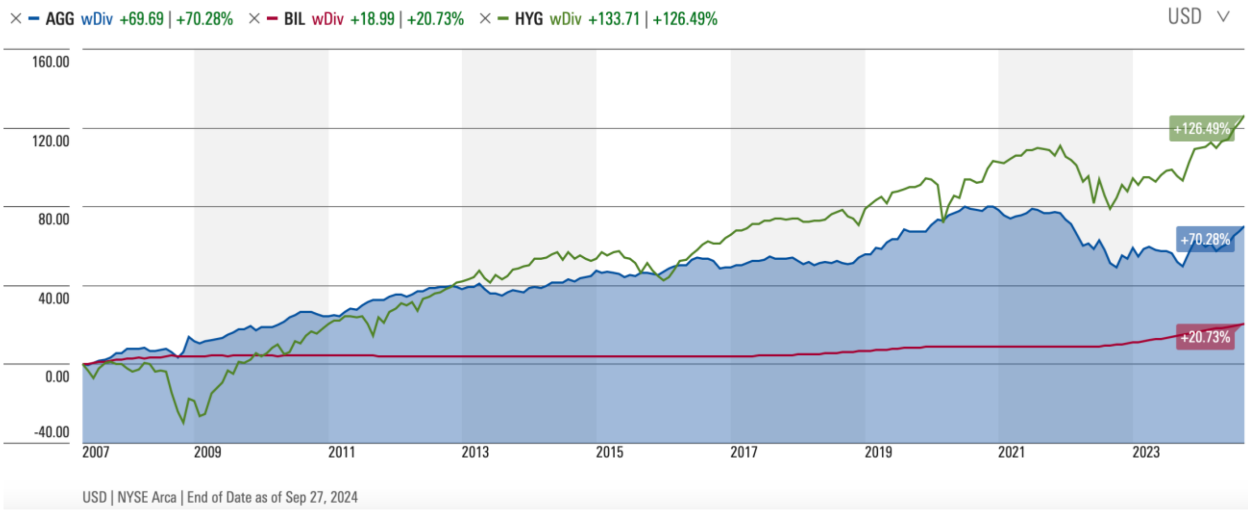
It's really that simple, rub your crystal ball and forecast whether or not we have a recession in the next year. Or you can play the long game: ignore the short-term points and be patient.



Looking at interest rates, we can see that the two-year yield has finally moved slightly below the ten-year yield giving us a slight upward sloping yield curve.



Another interesting chart is the performance of the U.S. Aggregate Bond Index (AGG), versus the U.S. High Yield Bond Index (HYG) and the 1 – 3 month Treasury Bill (BIL). While you had a bumpier ride in high-yield, especially during recessions, you were more than adequately compensated for that short-term volatility.



Again, volatility is not risk, volatility is opportunity; long-term loss is risk. If you are willing to ignore short-term points and focus on the long-term, your patience should be rewarded.

As always, be careful out there.

Chris Wiles, CFA

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