

Human Bias

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The Tacit approach to investing stands apart from conventional wisdom.

While most investment managers diversify across asset classes, we focus on diversifying risk across low-correlated investments, carefully considering each asset's risk contribution to the overall portfolio. We believe this distinction is crucial. Traditional approaches may be too passive in their growth allocation, potentially missing optimal opportunities and underperforming client expectations.

Our 'Growth/Stabiliser' portfolio structure compels us to make decisions that many peers avoid.

After years of rising US equity markets, a fundamental truth remains. Not all equities are created equal. The price you pay today determines your future returns. Purchase an expensive investment now, and your long-term returns will inevitably be lower than they were previously, all else being equal. This is the essence of "buy low, sell high."

At Tacit, we maintain a firm conviction that mean reversion exists in equity markets. We don't follow this principle blindly. We constantly evaluate compelling arguments that might challenge our assumptions. However, throughout our careers, we've witnessed numerous "new paradigms" that ultimately reminded us (sometimes brutally) that valuation always matters. The technology bubble, property bubble, and Japanese stock market bubble serve as stark reminders of this reality.

Building on our recent analysis of active managers' struggles to add value, we believe a deeper, more persistent issue underlies current market dynamics. Investors remain psychologically scarred, overly focused on past events rather than future opportunities. The 2008 financial crisis continues to shape investment decisions, having inflicted permanent capital losses on both individual investors and professionals, particularly in banking and property sectors.

This emotional bias clouds judgment and introduces unconventional risks. Yet we believe well-run, adequately capitalised financial companies are positioned to deliver above-inflation returns. Our mean reversion analysis suggests these companies are attractively priced, and the steeper government yield curve now allows banks to generate sustainable profits, potentially offering true portfolio diversification.

Most active managers remain underweight in sectors like banking, having avoided these companies for over a decade. The conventional approach would be to continue this avoidance. However, we believe "cheaper" assets such as bank equities must play a leadership role in future equity market performance, particularly as the era of zero interest rates appears definitively over.

The investment environment has fundamentally changed from five years ago—we're simply not convinced most market participants have recognized this shift. The key to successful investing lies not in avoiding bias entirely. (an impossible task), but in recognising when our psychological tendencies might be working against our clients' best interests.

Rather than embedding our own biases based on recent experiences, our approach emphasises maintaining objectivity through a targeted allocation to index tracking exposure. This strategy allows us to capture opportunities in undervalued sectors like banking without compromising client outcomes through emotionally-driven decisions. By maintaining this disciplined awareness and adapting our approach accordingly, we aim to navigate the changing landscape while staying true to our core investment principles.

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