

Madness & Manias Part 2

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Following on from last week's Thought, we received various questions regarding the practical implications of 'Madness and Manias' for our investment approach at what is a confusing time for many of our clients.

In reality, politics and newsflow in the modern world are volatile. The 24 hour news flow generated for the digitally connected world does not and can not determine investment values other than to increase volatility in prices in the short term. Ultimately it is economics and investment cycles that drive cashflows (and value) and it is vital to remember this at junctures such as this.

Just as markets can get overexcited about the prospects for a company or economy, they can get equally pessimistic about their prospects too. Ultimately it is the price that you are willing to pay for the future growth that dictates if something is valuable to you. In practice, negativity can throw up opportunities if you understand the true value of something.

The key point here is that high levels of uncertainty do not necessarily lead to poor investment returns or outcomes. In reality, history shows that investing during uncertain times in cheap asset results in very strong 'real' returns. It is for this reason that at Tacit we have actually been adding to equity holdings over the past weeks from our underweight position. Valuations in certain regions such as Asia and the UK are trading at levels seen during recessions rather than the environment we currently find ourselves in of slow but positive global growth.

To generate 'real' returns in the current environment when cash rates are near zero, investors must accept buying equities with high valuations and hope for continued supernormal profits being generated by companies such as Netflix or buy cheap equities that have been priced down due to environmental, political or economic concerns such as BP. Ultimately however, you are buying a cashflow, whether growing or not, and the price you pay for every unit of this cashflow today will determine your future return more than the potential growth in 9 out of 10 instances. This is the historically proven fact and why, at Tacit, we do focus on cashflows rather than blue sky thinking.

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