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Do not chase the market

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With equity markets near all-time highs we find it fascinating that everybody wants to embrace risk. This is primarily due to the concern of missing out on returns as investors worry that they will not meet their objective if they are not benefitting from good times in equity markets.

This is true: it is important to be exposed to rising equity markets to meet most peoples' longer term planning needs. There is a but however. Chasing returns has historically led to losses which can impact your longer term planning as much as not being invested at all. The key is to understand how a fall in the value of assets can impact your longer term objectives.

To illustrate this we have charted two scenarios below: in the first, an investor generates 6% returns in rising markets but suffers a drawdown (loss) during the period of 20%, whilst the second investor only generates 4% returns but suffers a 10% loss during the investment period.

Intuitively the investor generating a 6% return feels better in year 3 as their investment has risen more than the second investor. The impending loss in year 4 however will lead to their portfolio being significantly under water and ultimately lead to lower returns over the 7 years.

Equity market returns are not linear and it is vital to remember this during periods such as now. At Tacit, our focus at the moment is very much on the risks which a more volatile equity market environment could pose for our strategies. Valuations are no longer cheap in many markets and investors are showing many of the behavioural traits that have historically meant being cautious and patient will provide the best returns rather than chasing returns.

Investment involves risk, that however does not mean that risk should be taken on without understanding the potential implications.

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