

Remember Your Objective in Difficult Times

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Investment returns are never generated in a straight line. If they were, life would be much simpler. Over the past week we have seen a significant fall in equity markets, with technology shares bearing the brunt of the selloff following many years of positive returns.

At Tacit we have always explained that you cannot forecast a market fall but one thing you can forecast is that when a market correction happens, those companies that are trading at expensive prices fall the most and those that are cheaper fall less. This is driven simply by investors reducing their time horizons. For example, a company trading on a Price to Earnings (P/E) ratio of 20 means that an investor is willing to buy 20 years' worth of earnings today. Well, when uncertainty rises, it is not a surprise that an investor is not as interested in longer term earnings and the same company falls to a P/E ratio of 15 times. This results in a 25% capital loss. If this company was trading on a P/E of 10 it is unlikely to fall as much as investors are already taking a shorter-term view of the company and therefore capital losses would be limited.

The past week has seen a fall in these expensive companies as investors have altered their time horizons. This was inevitable in our view and a healthy sign for investors. Markets are clearing mechanisms and help to find a new equilibrium price for any given environment very quickly. Now, this creates volatility, but, volatility is not always bad.

Our strategies have allocations to 'Stabiliser' assets exactly for periods such as this. In the past these assets were primarily government bonds and gold bullion but with bond yields rising from historic lows our strategies have held significant cash positions for a while now. This cash is held partly in lieu of government bonds and partly because we have remained cautious on some of the more expensive areas of the equity market. The current volatility might actually provide some opportunities for long term investors that have not been available for nearly two years.

Our focus as always is to preserve values first and grow them when market opportunities arise. The good thing about volatility is that these opportunities are closer today than they were a week ago.

Whilst we look for these opportunities, investors must always remember their longer-term objective and time horizon. Extrapolating to the upside or downside has never helped you achieve your objective.

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