

The long term is difficult to predict

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This week Goldman Sachs published some research which concluded that they expect US equity returns to be lower than the rest of the world over the coming decade. This would be a reversal of the past decade which has seen US equities outperform almost all other markets by a substantial margin. The basic rationale for the conclusion is based on very long-term analysis of equity valuations and the expectation that valuations will revert to some long-term mean (average). If an equity is cheaper than today's average, it will perform better than an equity which is more expensive than the average.

This got the team at Tacit thinking. We are firm believers in mean reversion in investment markets. Over the past decade and a half, we have grappled not with the concept of mean reversion still being valid, but more with the time one has to wait for this reversion to happen. The long term is difficult to predict. The Goldman analysis has got many headlines, but when will it prove true? Over one year, five years or ten or even twenty years?

After thirty or so years in the business of investment management you learn that investment management is best done with an open mind but grounded in historic experiences.

Recently for pressing reasons of space, one of the team had cause to cull this overgrown collection of economic and investment literature. It brought to our attention several volumes that have proved invaluable to us over the years in analysing the truly staggering growth in financial markets and the financial instruments traded on them.

The first, "Financial Management with the Electronic Spreadsheet," (C L Wagner) dates to the mid-1990s but it is hard to believe that in the late 1980's we started running VisiCalc on Sirius PCs that required twin floppy disks to run: one program disk and one data disk. Today it is estimated that more than 2 billion people use spreadsheet tools daily, of which more than half use Microsoft Excel, the principal successor to VisiCalc.

This manual, it's not really a book, describes in detail how to build financial models using "Lotus123," a program that was then cutting edge but is now long forgotten. Fortunately, skills learned in one spreadsheet are portable to other versions. It goes without saying that financial practitioners today without spreadsheet capabilities are like doctors without a stethoscope.

"Sterling" (1985) by Douglas Jay (President of the Board of Trade) introduced us to long-run price series particularly with reference to UK price inflation going back as far as the middle-ages. The key insight was that long-term inflation is usually low as technological development pushes prices down. The very high inflation of the mid-seventies was thus likely an aberration, and that insight enabled us to position our fixed income portfolios for the decline in inflation that duly came from the early 1980s onwards.

"The Great Crash" (1954) JK Galbraith: one of the key recent insights of the behavioural economists is that quelle surprise, people are not always the rational actors that populate neo-classical economic models but can, and frequently do, behave irrationally and emotionally.

The story of the 1929 crash is compelling but Galbraith, an accomplished economist and policymaker under JFK, shows how the combination of ignorance, greed and leverage, leads to financial perdition. The story of Blue Ridge and Shenandoah (two corporations who invested in each other's stock) was echoed in the British Investment Trust industry decades later. Thus, Galbraith reminds us that the "financial memory is short."

Finally, no financial analyst worth his salt can fail to have read, “The Intelligent Investor” by Benjamin Graham, tutor and mentor to the Sage of Omaha himself, Warren Buffett. The clarity of Graham’s thinking has probably never been surpassed in financial writing making the book an indispensable source for budding and even “expert” equity investors.

Many more influential books fell off the shelf, but these are just a few that have shaped our thinking in the many decades that clients have entrusted us with their savings. No one of them is wrong in the long term, however only experience can teach you why some of the teachings can look incorrect for decades at a time.

2024 Q3 Tacit Thought Live Webinar

We are pleased to confirm that the recording of the 2024 Q3 Tacit Thought Live Webinar has been uploaded to our website, and can be found here: [2024 Q3 Tacit Thought Live Webinar – Tacit Investment Management](#).

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