The value of a different perspective

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Cash has outperformed all other local asset classes, including equities, for an extended period. In equity markets, we have seen a similar (if less pronounced) kind of abnormality play out, with a narrow subset of stocks dominating overall market returns as the rest of the market languishes in neglect.

Importantly, it is not only in South Africa where we have seen equity markets narrow in this way – internationally, the dominance of tech stocks has been spoken about a great deal, and Apple became the first US company to reach a $2 trillion market capitalisation. The S&P 500 has now become more concentrated in the top five stocks than ever.

The longer the cycle continues, the greater the hazard becomes

This period of exceptional market behaviour has also meant that not all investment styles have been equally successful, with value investing languishing while momentum- and growth-driven investment styles have outperformed. While markets have always moved in cycles (and are always likely to do so), it is the persistence of the current cycle which is most troubling, and most likely to present a hazard to investors. The longer the current conditions persist, the more appealing past winners become, and the more eager investors seem to be to get involved in the action.

The irony, of course, is that as market dynamics continue to inflate the prices of these few select assets (without a fundamental change in the prospects of the companies themselves), the risks to investors increase. That is because we believe current rises in asset prices are simply a reflection of investors' willingness to pay more for these assets, rather than an indication of a fundamental improvement in the prospects of the assets. The current market darlings may be quality companies, but we need to question if investment at any price is truly warranted. We have long held that the initial price an investor pays for an asset is a key determinant of the long-term investment outcomes they are likely to realise.

The starting price of an investment matters

Fundamentally, if you buy the shares of a quality company for less than they are worth, then the chances are extremely good that you will be able to sell them later at a higher price. We call the difference between what we estimate a company is objectively worth (its intrinsic value) and its market price the margin of safety. The bigger the margin of safety, the bigger the chances of achieving long-term investment success. However, it seems that the prolonged period of anomalous market behaviour has caused investors to forget this fundamental investment truth.

The best time to buy at a wide margin of safety is when you least want to

Another investment truth that seems to have been forgotten, is the fact that the best investments are often made at times when it feels least comfortable to do so. The best times to find quality companies at a discount to intrinsic value, are at times of market distress, when sentiment is overwhelmingly negative. Looking beyond the narrow subset of index leaders, the current market conditions have produced an abundance of opportunities to invest in above-average companies at below-average prices, typically in the unpopular sectors of the market. These opportunities are, however, set in the context of a volatile market and are not evenly distributed. Hazards abound, because not all investments will be successful and overpaying for assets remains one of the greatest risks to investors. However, we have often seen that outsized rewards accrue to those who are willing to invest when others are fearful – and this also applies in the currently bifurcated market environment.

The value of approaching the market differently

Seeing through the noise and overcoming our own biases as investors does not happen easily. This becomes even more challenging when prolonged cycles are testing our resolve. Focusing on the factors we do control, like when we choose to buy and sell companies and at what price is now more important than ever. The value of a proven manager with an approach that stands apart from the crowd, as part of a diversified investment portfolio, should not be underestimated.

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