Martin Bros

MONITOR

Creating Long Term Financial Success For Our Clients

Welcome to the October 2018 Edition of the Martin Bros Monitor.

In this edition of the Martin Bros Monitor:

- The Ghosts of GFC Past...

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Equity market participants as a collective tend to be all positive or all negative. This is what gives us the volatility we are currently experiencing and what also provides the opportunities to level headed and emotionally removed participants. Perhaps this positive or negative persuasion is exacerbated by the modern media and the “instant” generation we now live in.

In our June edition of MBM, post the February sell off and subsequent recovery in equity markets, we wrote:

“The good news is we have seen volatility return to equity markets. Although this means that there will be quarters where we see lower portfolio values, this volatility is healthy for markets and also provides opportunities for further re-balancing of investments.

As always, there are potential geo-political threats to global markets and the prospect of a sharp reversal in bond rates should inflation spike, but from an earnings perspective, which ultimately drives equity markets, the outlook is positive. Australia is low growth, Europe is improving and the US is expanding corporate earnings at a decent clip. There is no impending earnings hole on the horizon, which should be supportive of equity valuations for the rest of 2018 and into 2019.”

In our pre Christmas 2017 edition of MBM we warned that the then benign market conditions needed to give way to more volatility for the sake of the medium term health of equity markets. February’s sell off was circa 6% and the current sell off is approaching 10%. Many quality stocks have fallen further than this though. In times of perceived “fear”, indiscriminate sellers take hold as buyers sit back waiting to try and see where it will end.

As mentioned, without these periodical sell offs bubbles can form. There was talk that stocks in the US were approaching overvaluation. Now, with this recent pullback and

earnings releases from most US companies over the last couple of weeks that again showed solid earnings growth, equities are not overvalued.

During every sell off, “it feels bad”, which is purely human emotion as in most cases nothing has changed at any one company (stock) from one week to the next. This emotion is stronger than “feeling good” when markets and portfolio’s rise. This is well evidenced by notable studies in human behaviour.

We are also heavily driven by our past experiences. Although the GFC turned out not to change any of our lives for the worse, any time since then we experience a market sell off, the receptors in our brain flash warning, market crash. Or maybe that’s just in the journalists who write the headlines and want to sell newspapers (or online subscriptions we should say!).

Despite this feeling, not every market sell off is going to be a crash. In fact, there is no reason to suggest that we will experience a crash like we saw at the peak of the GFC market sell off in March 2009. The Fear of a Crash is infinitely more real than the probability of one actually occurring.

At present, the market is worrying about when the US expansion will finish. It is guessing, like anyone without evidence. Even when the US economy rolls over and goes into contraction mode – which may be years off – there is no higher probability that equity markets will fall further than usual 10 – 20% corrections in severe market sell offs.

Clearly the media like to sensationalise matters. Current commentary would have you believe the end is nigh. I recall this same rhetoric in February. If you asked most people when the last major sell of was, most people would say the GFC so we are overdue. In fact, during the first half of 2016 our market fell 20% from peak to trough before recovering. We are somewhat conditioned to the fear of “the big one” because of our relatively recent GFC experience. In reality, sell offs of over 20% are very rare. Remember, the GFC was the worst sell off since the Great Depression.

We have no idea if the current sell off is at its bottom or whether it will fall a further 5 – 10%. But we do know is that it will recover and good companies will continue to pay growing dividends over time. The tricky part is to try and not over react, or under react to all of the noise. Which is what we are here to do for you.

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