➢ The Investment Perspective – October 2024

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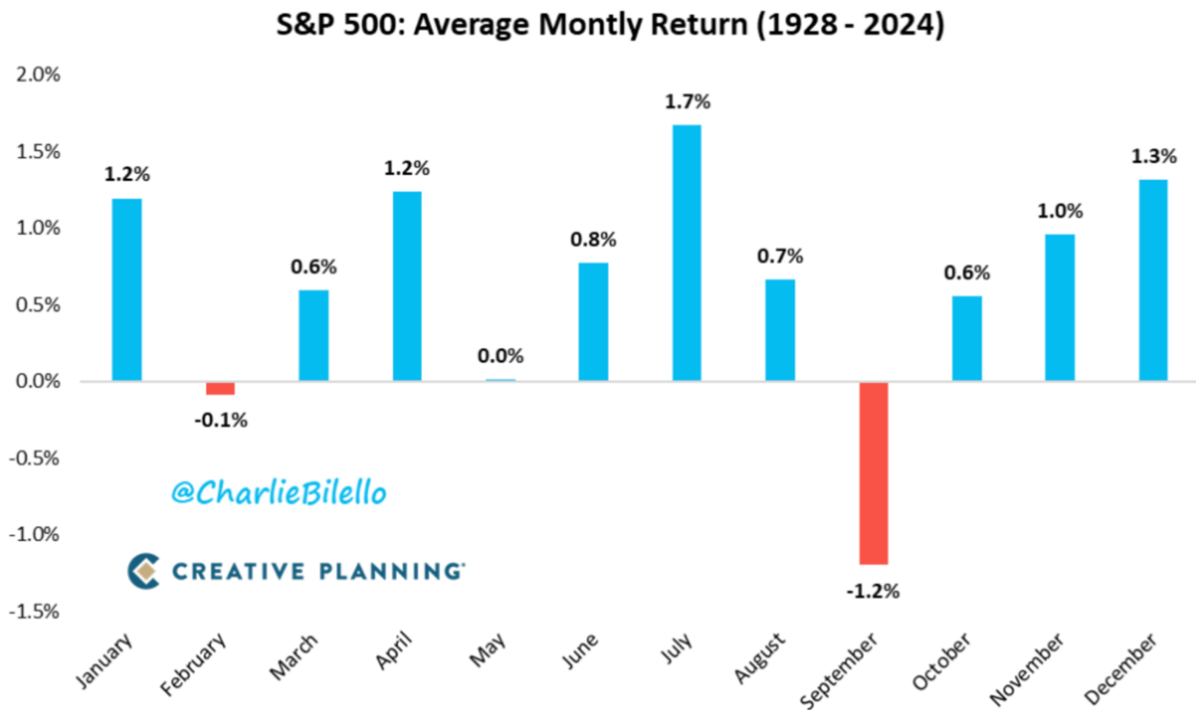
"Neither the investing method nor the fundamentals of the business are right or wrong because the mood of the market is favourable or unfavourable toward the "stock". That is because when you really think about it, "stocks" (shares) are all about the financials and the trading price, the share price…the cash up value. What matters more is the economics of the business."

-Peter Flannery

Modelling to Understand



The graph above tracks the S&P 500 average monthly returns since 1928

Financial modelling is done for a variety of reasons (e.g. understand what the change in one variable means elsewhere, forecast the future, and help make management or investment decisions). It can be very useful.

The problem with modelling is that for investors, markets are random. Modelling works, until it doesn't.

The graph above is interesting. We can see from the graph above that, since 1928 the average S&P 500 return for September is -1.2%. That is a fact. The return for the S&P 500 for September 2024 was +2.02%.

The Phillips Curve

The Phillips curve shows the relationship between inflation and unemployment. They are 'inversely correlated. When one increases, the other decreases.

Developed in the 1960s, economists have been watching the Phillips curve over the last few years however, it did not seem to work like in the past. Similarly, whilst it sounds logical, the stagflation conditions (high inflation, combined with high unemployment and stagnant demand across an economy) in the 1970's.

Markets are random and dynamic.

Investing Methodology

WHAT!?

Most people think about investing (as well as many other things in life) simplistically. For example, they think about what to invest in (e.g. shares, property, bank account, Kiwisaver). They are less inclined to think about how to invest – the methodology, the way.

Let's see – just for fun, off the top of your head, do you know the difference between:

- Value investing and investing for growth?
- Value investing and e-Biz Investing developed at WISEplanning?
- Trading and momentum investing?
- Modern portfolio theory and active investing?
- Passive investing and buy and hold?

You can just google all of the above (although there is limited information across markets about e-Biz Investing) however when you started investing, did you investigate these and other approaches to investing?

The Point

Models and analysis can be very useful. The trick is to understand when they are not.

For example, Modern Portfolio Theory is possibly the most widely used methodology (diversify, reduce volatility). Kiwisaver schemes in New Zealand all use Modern Portfolio Theory, not because it is the best, but because it is widely accepted in academic circles and 'safe'.

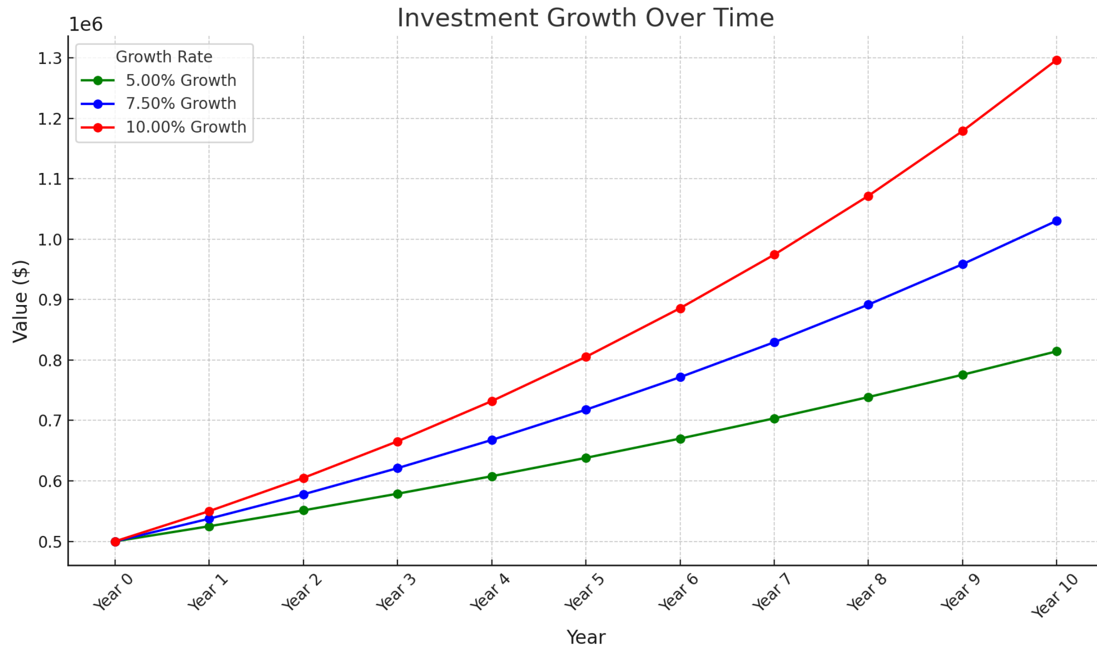
Warren Buffett and Charlie Munger did not use Modern Portfolio Theory. Nor did they use share brokers to get ideas on where to invest.

A cautious investor may benefit from some application of diversification. A 'smoother ride' at the cost of portfolio growth that may never happen. Still, that is suitable for them.

Guarantees are hard to find in the investment world. Markets are dynamic and random.

However, more advanced investors will want to abandon the limitations of the investment modelling inherent in the likes of Modern Portfolio Theory to unlock the long term possibility of improved portfolio growth long term.

Those compounding tables that we all learned in school are still relevant.



“People calculate too much and think too little.”
-Charlie Munger

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