COMMON SENSE AND PROPORTION*

Long-term savings and old methods

"Someone's sitting in the shade today because someone planted a tree a long time ago." *Warren Buffett*

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Those of you who have browsed through our Newsletters in the past few years will have realised that we are **compulsive readers** of anything in any way related to investment (reading list in the Newsletter of September 2016). We prefer **the classics** produced by long-term investment gurus such as Warren Buffett, Benjamin Graham and Charlie Munger (RIP). But we remain very open to **related subjects** (economics, psychology, history, etc.), and even to **more heretical** publications relating to speculation, provided that the protagonists have a minimum of credibility on the subject (Georges Soros, Richard Dennis, etc.).

We wrote in a previous publication (Newsletter of December 2020), that **investment and speculation should not be confused**, at the risk of losing your savings. And yet it is fascinating to note that **the quantity of content** relating to investment or speculation is **inversely proportional to the probability of success** of each of the two approaches!

In contrast with the latest "tip" indicating how to become a millionaire in a few weeks, this new Newsletter tends to demonstrate that the strategies which create "the most noise" do not necessarily offer the best return on investment in the long term. Conversely, **there are simple and extremely robust approaches** to make your savings work for you with a very high probability of success.

The purpose of these letters is to share ideas and points of view on a variety of investment-related subjects, while attempting to show common sense and keep a sense of proportion. In the field of investment management, as in many others, knowing that something exists does not mean being capable of measuring it. The content of this document reflects the authors' views at the time of going to press and is accurate to the best of their knowledge.

Let's start with some figures: there are more than 40,000 English-language reference works on sale on Amazon (1) which mention ***"Trading"*** (*Day Trading*, *Crypto-Trader*, *How to day trade for a living*, etc.). On the other hand, there are less than 1,000 books with ***"long-term investing"*** in the title (*The Intelligent Investor* by Benjamin Graham, for example).

With the development of social media, even trading has its star influencers! Or even its gurus, like Elon Musk, who, in one tweet, cause the latest fashionable cryptocurrency to gain or lose hundreds of millions of dollars in value.

"Get rich or die trying"

- Curtis James Jackson, aka 50 Cent

Now, **the statistics** for the retail trading platforms **are conclusive**: about 80% of their clients lose money in a given year. Add to this the fact that these losers cease their activity after depleting their capital and that many of those who were lucky yesterday are the losers of tomorrow, and the probabilities of success are even far more unfavourable in the medium and long term.

Those who study **human nature** will find this not at all surprising. Human beings are partly driven by their "deadly sins": their **greed** (2) is **blind to probabilities**. Many businesses thrive on this character trait and have done so since (almost) forever; this is the case, for example, with gambling, e.g. casinos and lotteries. Note, however, that there are very few books explaining how to win the lottery.

And yet this is a serious matter. Leaving aside the occasional adrenaline rush produced by a lottery ticket or a rational casino outing, hazardous investments can have **significant financial consequences for our future**, especially for the quality of **our pensions.** As a reminder in this respect, given the low level of real interest rates and the liabilities of most pension systems (direct or indirect), it is now in the interest of everyone to take their financial future in hand, to avoid future disappointments.

And yet, led astray by our basest impulses, many of us commit their savings to **zero-sum games**, **but which are not without friction costs** and thereby jeopardise their future. They refuse to admit that the future is largely unpredictable and that speculation requires having a "significant" ability for prediction in a field which is nevertheless infinitely complex. That can work (*case rate*), particularly over short periods, but **it is a bet against common sense** (*base rate*).

Why look for complications and high risk when you can do things simply and effectively?

For the average person (incapable of predicting accurately on a regular basis), which includes us humble investors, the **long-term investing discipline seems far more accessible and reasonable** than frantic speculation. Especially when you have grasped **the following four basic principles**.

1- In the long run, equity markets track the wealth creation of businesses

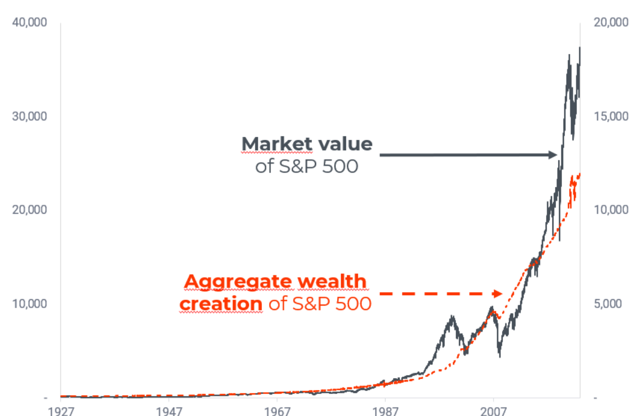
Over the long run, equity markets as a whole cannot be considered merely as **a casino**, and even less a zero-sum game. They tend to reflect the added value created by businesses. There is a **direct and objective causal link** between value companies' value creation and markets' growth.

And the longer the time frame, the stronger this link.

"In the short run, the market is a voting machine but in the long run it is a weighing machine."

- Benjamin Graham

Graph 1: Evolution of the S&P 500 Market Value vs. its Value Creation from 1927



Note, however, that the accounting assessment of value creation by Net Asset Value (NAV) is reaching its threshold in the 21st century, due to the growing proportion of intangible assets, the existence of off-balance-sheet liabilities, etc. There are grounds for **preferring a so-called "normalised" approach** (VIA leap article).

2- Equity markets are very volatile: they can fluctuate by tens of percent in a few months or weeks!

While volatility is often **a risk for the speculator,** it is above all **a source of opportunity for the investor.** Periods of market stress are all opportunities to acquire good-quality assets cheaply. Periods of exuberance can also be used to reap profits that are higher than expected.

"The time of maximum pessimism is the best time to buy and the time of maximum optimism is the best time to sell."

- John Templeton

This is especially true for a market as a whole or for a sufficiently robust and diversified asset portfolio, **but less so for the shares of a single company**, or a concentrated basket of securities, which could collapse for good reasons. The phenomenon of creative destruction is very powerful and no business is immune. You must be sure to be exposed to a sufficient diversity of economic activities, e.g. with an ETF concerning a very broad index (such as the MSCI World All Countries, which comprises more than 2,000 different companies). And/or choose an active management process, which adjusts its securities portfolio dynamically, by allocating capital to the best-performing companies.

3- As an investor, the greater the price you pay, the lower your potential gain becomes…

Of course there is a **limit to the principle that a long-term investment in equities** wins every time. This limit is, above all, the price paid. Else being equal, the higher the price you pay (even for good assets), the lower the probability of gain is. Especially during speculative phenomena, bubbles, etc.

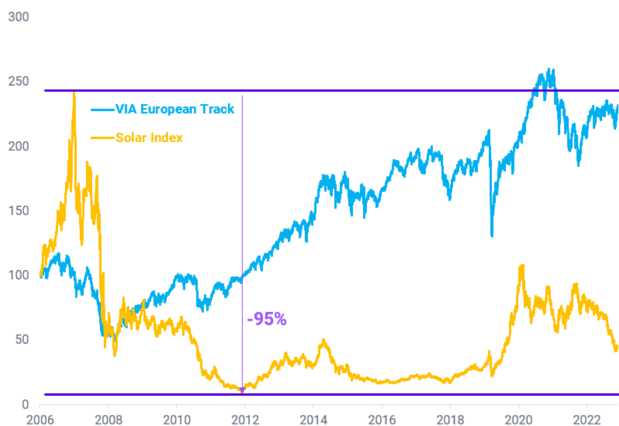
"Price is what you pay, value is what you get."

- Warren Buffett

Investment history is full of extremely **explicit and sometimes dramatic examples.**

Graph 2: Market Value of Japanese Market from 1985 (NKY Index Price Return)

Graph 3: Solar Bubble – VIA European Track (EUR) vs. Solar Index (SUNIDX Index)



From the shareholder's perspective, the link between economic performance – value creation – and the purchase price is of fundamental importance on two counts. **It is not the securities that create value**, but the economic assets to which these shares expose us to. The higher the purchase multiple, the less assets one owns and the less one is exposed to wealth creation. In this sense, in-depth fundamental analysis, such as an accounting normalisation process, makes it possible to correctly assess the real value of assets, liabilities and revenues.

In the end, long-term investment, without claiming to be predictive, would amount to **acquiring exposure to the wealth creation produced by companies' assets via their shares, while smoothing the risk** represented by entry timing. And trying to profit from periods of gloom to add to positions, while endeavouring to reduce exposure during periods of exuberance.

4- On the relative futility of a bet on the end of the world

The idea that reasonably priced equity markets offer unfailing potential for long-term price appreciation is **not strictly accurate**. In 1917, "patient" investors in Russian equities never retrieved their capital.

The long-term performance of equities **depends on the persistence of a system similar to capitalism and the rule of law**, or even quite simply the existence of a system. The geographic and sector diversification of a portfolio could probably provide a cushion against a hypothetical localised Bolshevik revolution in the future, but they would definitely prove ineffective in the event of a nuclear war or another apocalyptic event. But here, long-term savings won't matter anymore… And a short seller would ultimately have little chance of profiting from the success of his bet!

The winning formula of gradual "horizontal" investment over time, or *dollar cost averaging*

This is **one of the best-performing equity strategies** from a risk/reward standpoint. And one of the most widely seasoned, even if its users have not properly measured its intrinsic qualities, moreover.

Equity markets are volatile by nature. If you invest **in one go, you have volatility "against you",** whereas if you invest in **several operations, you have it "with you".** In the first case, the **chance factor** will account for a large part of the future performance. In the second one, you acquire exposure to a **moving average of the economic cycle**, with its good and bad times. And you will be able to capture a good part of the underlying wealth effect.

This very intuitive approach is also **very popular.** Probably because it is **highly accessible**. Most savings management offers propose and even encourage investment smoothed over time. But paradoxically, very few users really measure how **effective it is in coping with the worst stock market periods in history.**

We specify here that we are not speaking of smoothing over a few weeks or a few months, but **throughout an economic cycle**, i.e. over many years.

Graph 4: 1927-1947 – DCA investing vs. one shot investing

We strongly encourage investors to manage their equity savings in an automatic and smoothed manner, **for both investing and divesting**. By divesting gradually, you limit the risk of unlucky exit timing.

The winning formula of "vertical" or *ladder* investment.

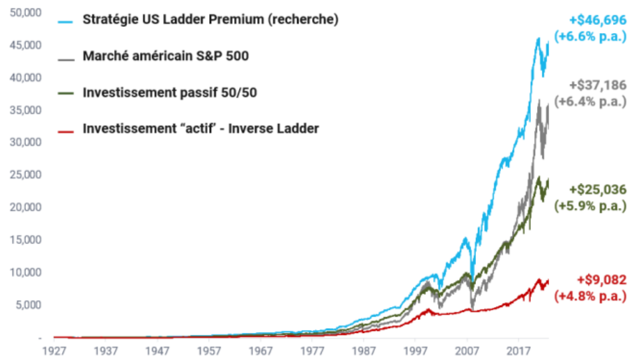
Here too, the method consists in investing and divesting gradually, but **in downturns and upturns** depending on market fluctuations rather than over time. The myriad of factors (number of levels, reference point, leverage, etc.) imply that there are **a large number of *Ladder* approaches.**

This strategy is almost never proposed by investment professionals, even though its principle is just as **intuitive** as the *dollar cost averaging* approach. And when it is practised, it is seldom in a structured manner. **And yet it proves extremely effective**.

It is worth noting that an opposite approach (*Inverse Ladder*) tends to destroy value, even though most investors, including the professionals, are driven to follow it. Psychological biases (fear and greed) and career risk, in particular, very often lead investors to sell in downturns and buy in upturns. In the same vein, human beings tend to try to predict and watch for market downturns, at costs that are often prohibitive.

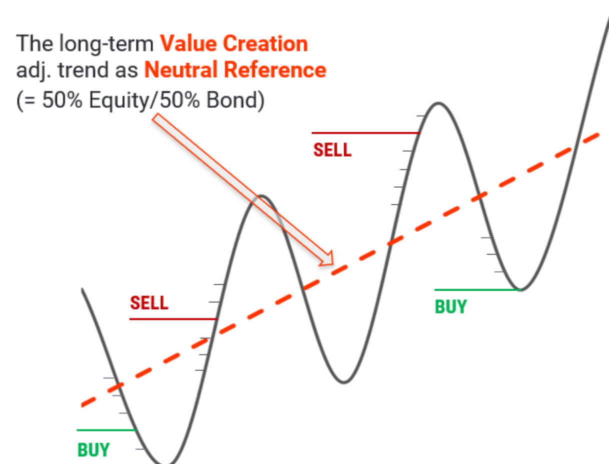
> ***"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."***
>
> **- Peter Lynch**

Graph 5: 1927-2023 – Ladder US simulation for $100 invested in 1927



Dollar cost averaging remains very simple to manage: for example, investing €100 every month in a good diversified equity fund. Conversely, programming investment in downturns and divestment in upturns is far less accessible and implies constantly defining and managing numerous factors.

Graph 6: Central Value Creation mechanism



The reference level, *i.e. the market level at which the proportion invested in equities is equal to the uninvested proportion,* is the first of these factors. It seems logical to define it as the rate of the market's economic value creation. Since this tends to evolve over time, the reference level also moves and it is therefore necessary to be able to calculate it, like a "moving" neutral point. Next, it is about sizing the level of markets' divergence from this neutral point which will trigger a given investment or divestment. Finally, one should be capable of investing or divesting very swiftly since markets can diverge at any time. One can also decide to introduce a certain amount of leverage, so as to continue investing when markets are very depressed. Lastly, it is essential to choose risk-free (or low-risk) assets in order to allocate the proportion not invested in equities. **So much for the theory**.

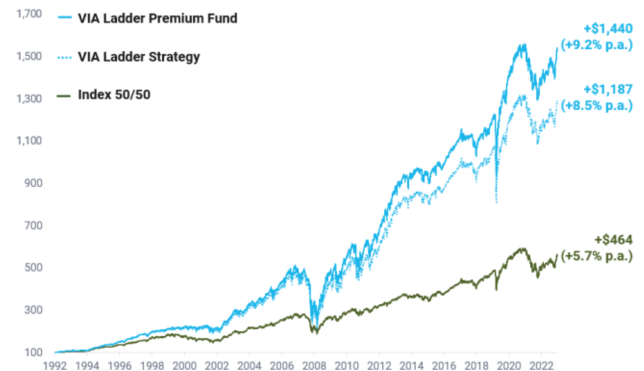
From a practical standpoint, it seems preferable to use a **dedicated investment vehicle**, for which the assumptions are clearly defined and which is managed by **fund managers having the necessary tools** to calculate the parameters and execute transactions in the best possible conditions. Outside such an investment vehicle, investment professionals should formalize the strategy precisely and constantly supervise its execution. Given the format of management mandates and the constraints placed on those who manage them, it seems illusory to imagine using a *ladder* approach on an "industrial" scale. Each investor can implement the method themselves, and some already intuitively do so partially. But given the scale of the operational constraints, it will not be possible to follow the approach entirely.

Although it is hard to implement outside a dedicated investment vehicle, a ladder type strategy proves extremely **effective in making your long-term savings work for you.** However, it is possible to obtain even more convincing results, like an "icing on the cake", by optimising the execution of equity exposure. Indeed, ***markets are ready to pay a premium to those who are***

prepared to buy in downturns and sell in upturns!

Along these lines, for some years now, we have developed an approach making it possible to receive option premiums. Rather than placing buy and sell limits, it is possible to sell options and be rewarded by the market for positions that you wanted to take in any case. Here, we are **not very far from a free lunch.**

Graph 7: 1992-2023 – VIA Ladder Premium Fund



Conclusion

We have been professional investors for more than 20 years, but we have **not found an accessible wonder technology** enabling investors to become millionaires in a few months without taking excessive risks or without having a lot of luck. And yet we have looked for one! **But**, as we have just described, **relatively simple and very effective approaches exist** for the longer term.

Giving investment advice is always perilous, but we really encourage our readers concerned for their retirement to **make extensive use of both the *dollar cost averaging* and *ladder*** approaches, or even combine them.

For the first approach, solutions probably already exist with your investment firms. For the second one, everyone can try to adapt their allocation to major market movements. But given the lack of a structured product offering, we have seized the opportunity to launch a dedicated fund, **VIA Ladder Premium**. It benefits both from our ability to measure the wealth creation of equities using VIA leap®, and from an implementation technology which makes it possible to capture an "execution premium".

"When I was young, I used to think that money was the most important thing in life; now that I am old, I know it is."

- Oscar Wilde

Sources

(1) <u>Amazon Source</u>: using the amazon.com search bar, selections of books in English, with two search keys: "trading" and "long term investing". With the selection algorithm, these two keys are imperfect and not strictly exclusive, with books that can be found in both categories, but they indicate the scope of choice for books discussing short-term trading as opposed to long-term investment.

(2) <u>Greed</u> is not strictly speaking one of the seven deadly sins in the biblical sense (avarice, envy, sloth, gluttony, pride, lust and wrath), but an expression of avarice and envy.

<u>Graph 1:</u> Evolution of the S&P 500 Market Value vs. its Value Creation from 1927. Sources VIA AM, Bloomberg.

<u>Graph 2:</u> Market Value of Japanese Market from 1985 (NKY Index). Sources VIA AM, Bloomberg.

<u>Graph 3:</u> Solar Bubble – VIA European Track (EUR) vs. Solar Index EUR (SUNIDX Index). Sources VIA AM, Bloomberg.

<u>Graph 4:</u> 1927-1947 – DCA investing vs. one shot investing. Sources VIA AM, Bloomberg.

<u>Graph 5:</u> 1927-2023 – Ladder US simulation. Sources VIA AM, Bloomberg.

<u>Graph 6:</u> Central Value Creation mechanism. Sources VIA AM.

<u>Graph 7:</u> 1992-2023 – VIA Ladder Premium Fund. Sources VIA AM, Bloomberg.

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