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INVESTMENT MANAGEMENT

SLIMMON'S TAKE > TAKEAWAYS & KEY EXPECTATIONS

Andrew Slimmon December 2019 Equity Market Commentary

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1) I love podcasts. The range of available content is incredible. When I am on the train, on the treadmill, or walking the dog, I can always find something of interest.

   The other day, I listened to an interview with famed investor Howard Marks. Here is one of his quotes:

   > *Nothing we do at Oaktree is based on forecasts. I am strongly opposed to basing investing on forecasts. And what I say is, we never know where we're going, but we sure as hell ought to know where we are".* [1]

   How true that is.

2) At the beginning of the year, who among us would have predicted that the Fed was going to cut rates three times because the economy was so weak, the China trade war was going to heat up all year, and the Democrats would proceed with impeachment against the President? Furthermore, I am quite sure that if those conditions were communicated to us ahead of time, very few of us would have gone on to say "despite that backdrop, I believe the S&P will be up 24%."[2] Yet that is where we are.

   I think way too much time is spent trying to predict and analyze macro events, let alone correctly concluding their effects on the markets.

3) Instead, let's understand as Howard Marks says above, "*where we are*". Here are some facts:

   a. The market (S&P 500) is up 24% this year.

   b. Investors have pulled $190 billion (net) from equity mutual funds/ETFs this year, mostly in the first six months, thereby largely missing out on most of that +24% YTD return.[2]

   c. The asset class that has experienced more net inflows than any other asset YTD is the money market fund. *Over half a trillion dollars has poured in.*[3]

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4) That reminds me of a quote by another great investor: "be fearful when others are greedy and greedy when others are fearful".[4]

5) If the money market is the most popular asset this year, are investors greedy or fearful? I doubt anyone is investing in the money market purely for the puny interest rates being offered….

   When assets are chasing out of money markets and into equities, I will get worried. That is NOT *where we are currently*. Quite the opposite.

6) As I wrote in last month's commentary, rising fear is a classic behavioral tendency AFTER a big drawdown. We have seen selling AFTER the drawdown of 2018, just as there was selling in 2012 AFTER the drawdown in 2011 and selling in 2016 AFTER the drawdown of 2015.[5]

7) But that is changing. Investors are starting to realize that maybe selling was a mistake and perhaps they should have been buying.[6] It takes about a year of the market going up following a dramatic decline for investor behaviors to change. This is why the market rallied in 2013 and in 2017. Fund flows reversed and turned massively positive.[7]

   I think we are in the early innings of this capitulation. To me, it entirely explains why we had only three down days after Thanksgiving despite an incredibly strong market leading up to the holiday. The weakness, albeit minor, created a buying opportunity for those on the side-lines, thereby stopping the decline.

8) Without a doubt, somebody who is reading my comments is thinking something along the lines of, "Andrew is so off-base, there is *no way* 2020 will be like 2017, because we had tax cuts in 2017 and that won't be happening in 2020."

   I agree it's highly likely we won't have tax cuts in 2020. But then, please re-read comment #1. I know *where we are*. And I am more willing to bet that human behavior doesn't change much than I am willing to bet on forecasts.

9) One final note. Guess what else happened in 2013 and 2017? There was very little volatility in the market, with no bad drawdowns during either of those years.[8] Why? Because every market pullback created an opportunity for some portion of that excessive pile of money market cash to find its way back into the market, thereby blunting the pullbacks. Could that happen again in 2020?

   That sounds too much like a forecast. I am sticking to *where we are*: ***a rising stock market and piles of cash on the side-lines.***

Andrew

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[1] Motley Fool November 29th.
[2] Merrill Lynch, The Flow Show. November 21, 2019.
[3] Merrill Lynch, The Flow Show. November 21, 2019.
[4] I would suggest an investment class if there is any uncertainty of who said that.
[5] Investment Company Institute.
[6] Weekly flows into US equities were positive last week for the first time since one week in February and before that not since November 2018. Investment Company Institute.
[7] Investment Company Institute.
[8] In 2013, the largest peak to trough selloff was -5.6%. In 2017, the largest was -2.8%. Factset.