CREDO
WEALTH

Blood on the streets?

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The last few weeks have seen some of the most volatile times in markets in recent history. Whilst the weakness to date cannot (yet?) be compared with the global financial crisis of 2008, all major indices have now seen double digit declines. What this means is that we are now officially in "correction" territory; if markets slide further and register declines in excess of 20% from their highs, it will for evermore be referred to as the Crash of 2015.

Against this background, we understand that many clients will be concerned about the state of their portfolios. In particular, what should one do in times like these?

In response, we would like to start by reiterating a couple of key points from Credo's investment philosophy.

Firstly, we have consistently managed money by following a low turnover strategy which is focused on the longer term. Accordingly, we do not believe that it would be in anyone's interest to participate in panic selling when a lot of speculators seem to be running for the doors. If anything, this is probably a time to get more fully invested… in the inimitable words of Baron Rothschild: ***"The time to buy is when there's blood on the streets"***.

Secondly, at Credo, we believe in a value-based approach to investing. Over the past few years, this has proved to be challenging as momentum has trumped value in a time of quantitative easing (QE). In hindsight, this probably stands to reason: if "money costs nothing" (as has essentially been the case as a result of QE), it shouldn't really be a surprise that investors have been less discerning in looking for real fundamental value when buying financial assets.

As a result of this, a number of value investors have been under performance pressure for some time now. Against this background, we have in fact been privileged at Credo not to suffer quite as much as some (even though our flagship Best Ideas Portfolio as well as the Dividend Growth Portfolio have been slightly behind the benchmark MSCI World Index over the past year).

We have, however, also been using the last couple of years to position our portfolios slightly more defensively, given that we recognised the fact that markets had become relatively expensive in historic terms. This was in fact also the theme of numerous presentations that we made to

clients over the same period: we have been at pains to manage expectations and warn clients that the strong returns of 2009-2014 were unlikely to be repeated over the next few years.

This defensive positioning should now stand us in good stead, at least in relative terms, as momentum stocks are generally affected more adversely than the more reasonably priced value situations when markets decline.

To illustrate: it's probably too early to judge this properly, but we do take heart from the fact that Credo's Dividend Growth Portfolio (the more defensive of our equity portfolios) has outperformed the MSCI World benchmark by 1.6% during August alone (until the 21st of August, i.e. the most recent available data point at the time of writing). Going back a further month to the beginning of July 2015, the outperformance of this portfolio amounts to some 4.2% (in both USD and GBP terms). Performance of the Best Idea Portfolio has been more modest (but this portfolio has also outperformed the benchmark during the month of August to date).

What is probably more important, however, is to stand back from the current market turmoil and make some more general points.

Firstly, we would like to remind clients that market movements such as those experienced at present are quite normal and to be expected from time to time.

This point was explained most eloquently in a piece by Morgan Housel (economics and finance columnist for Fool.com) nearly 18 months ago, from which I have lifted the following quote:

"So, here's the weird paradox: If stocks never crashed - or if they gain the perception that they don't crash - prices would rise to the point where a new crash was guaranteed."

Housel continues to explain this seemingly counter-intuitive point with reference to the work of Hyman Minsky, an economist who spent his career studying why economies boom and bust and ultimately theorized that stability is in fact destabilising.

In the same piece, Housel also quotes Warren Buffett's long term confidant and partner, Charlie Munger, as follows:

"You can argue that if you're not willing to react with equanimity to a market price decline of 50% two or three times a century, you're not fit to be a common shareholder, and you deserve the mediocre result you're going to get compared to the people who do have the temperament to be more philosophical about these market fluctuations."

Those who have studied Messrs Buffett and Munger and their investment success over the past six decades, will know that these gentlemen never concern themselves with economic forecasts, strategy outlooks or market fluctuations. They simply continue to focus relentlessly on building a portfolio of quality assets at reasonable valuations – which is ultimately what we also try and do for every client of Credo.

In conclusion, we would like to remind clients of the theme of our most recent conference: "Keep Calm and Carry On". We understand that some clients will be nervous, but we also believe it is worth remembering that, when everyone panics at the same time and decides to sell as a result, bottoms are formed. It is trite to point out that those who participate in such panic selling will lock in permanent capital loss.

In slightly contrarian terms, we do in fact believe that this is a time to become more bullish, as investors with cash to deploy can put money at work at valuations that are much more reasonable than what they used to be a short few weeks ago.

More than 200 years have now passed since Baron Rothschild first saw blood on the streets and uttered his famous words. Investors with the stomach to heed his advice have never been disappointed, as long as they have also had the patience to await their reward… why will it be any different this time? ■