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A Couple Of Events In An Uneventful Quarter

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The explosive gains in the equity markets seen during most of last year and the first part of 2021 were significantly tempered this last quarter ending September 30th. Worries about supply chain constraints and inflation appeared to have somewhat dampened the market revelry, and an empty punchbowl could lead to an ugly hangover. If that's the case I'll be happy that we continued to take our pre-emptive remedy (i.e. cash) during this prolonged festive season.

So far the markets have been surprisingly resilient. I recently came across an interesting story about the resurgence of day trading activity (remember the dot-com bubble?). Apparently, many of the mobile trading platforms geared to amateur investors are designed with prompts and digital features designed to encourage stock trading in a manner akin to online gambling sites. The term "gamification" is being used to describe how these sites are affecting investment behaviour. I've come across articles discussing how gambling addiction helplines have noticed an unprecedented uptick in calls from people suffering from an addiction to day trading.

The other end of the spectrum is what I call the "ostriches", people who park their money in index funds under the belief that they will be better off by saving some money on fees. The sustained growth in market values has lured more money off the sidelines and into index funds, further perpetuating the bull market and making those investors feel complacent. Many have fallen victim to the psychological trait called "recency bias" - taking a short term data trend and extrapolating it forward. As I've mentioned before, investing in index funds means that one is exposed to the kind of stocks I avoid in my efforts to manage risk (companies with poor balance sheets, or low profitability, or declining prospects, etc.). The index party looks great while market sentiment is positive - when sentiment turns this could cause a lot of pain for the ostriches.

> "An empty punchbowl could lead to an ugly hang-over."

Despite the continued valuations of markets at levels that I believe to be overly expensive, I was able to put some of the cash to work with recent purchases of a pair of Chinese internet stocks. Baidu's search engine business is akin to Google's, and Alibaba's online market sites are similar to Amazon. The Chinese government has been reviewing the heavy market concentration of companies like these and measures to curb their market dominance. Although such measures could have a dampening effect on their future growth and profitability, I'm of the opinion that the market reaction has driven the price of these stocks well below what their intrinsic values would be in likely scenarios. Even in a drastic case, I believe our downside is limited and far outweighed by the upside potential. This could turn out to be a classic example of markets overreacting to news and providing opportunities for rational investors with long term outlooks.

I'll continue to act on such opportunities when they arise, and at some point, the laws of financial physics should provide enough well-priced stocks to allow us to fully deploy our cash. In the meantime, I'll remain patient as always, protecting your capital - which I believe allows me to more effectively grow your capital.

At Your Service,

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