

News

The Cost of Bad Behaviours

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During periods of market sell-offs, the natural human reaction is to contract our investment time horizons and focus on short-term negative noise. It's at just such times, when our instincts may lead us in the wrong direction, that a well-established investment process can help to avoid behavioural pitfalls. Such a process might usefully include:

1. Modelling scenarios for companies using long-term timeframes. This helps to prevent decisions being made on short-term emotional responses
2. A valuation control and the discipline of using the same discount rate throughout the cycle help identify buy signals when 'the sales are on'
3. A portfolio built on a diversified set of long-term themes, focused on long-term growth and stable cash flows. Market pricing of those cash flows will tend to be a lot more volatile than underlying business performance

The past few months have seen darkening economic skies, reflected in some less than pleasant equity market returns. In the first six months of this year the MSCI AC World Index fell 10.86% in sterling terms, while the FTSE All Share fell 4.4%. It is at moments like this that investors need to focus on long-term thematic drivers of growth, along with disciplines around balance sheet leverage and valuation, to help ensure their portfolios have suitably resilient characteristics.

As real incomes are squeezed and social unrest builds, the areas of strongest spend are likely to be those which are essential to social stability:

- Governments and businesses need to spend more on re-shoring production and the capex spend linked to this will benefit companies servicing infrastructure projects
- The crisis in energy will see an acceleration in spend both to ensure supply of oil and gas and to build out increased renewables and nuclear capacity
- Politically there is a motivation to increase minimum wages, and to keep wage inflation as much as possible in line with the rising cost of living. Companies in the recruitment sector are likely to benefit, as are contract-based businesses where wage costs are passed on and companies where management is willing and able to invest in the technology necessary to offset rising costs
- Healthcare is another area where we see rising spend across the globe; spend that is only likely to increase as populations grow older. Particularly interesting are companies with specialist drugs and devices
- Rising geopolitical tensions are driving national security up the political agenda, drawing investors to take a fresh look at defence, where budgets are set to rise significantly over the next decade

All data from Bloomberg unless otherwise stated.

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