



Why “fear of missing out” is so dangerous

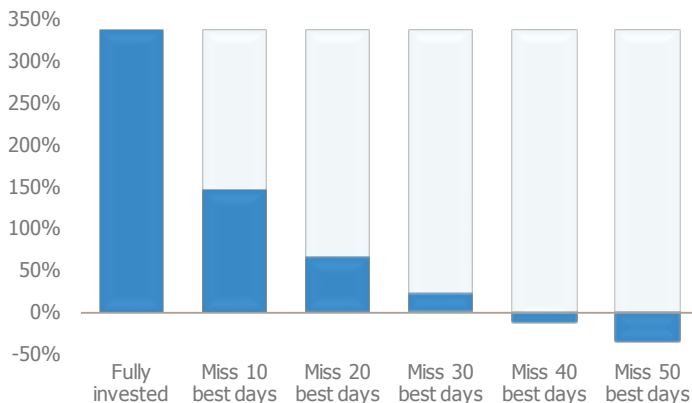
Ben Leyland, JOHCM Global Opportunities Fund

- For real world investors, risk is the danger of a permanent loss of capital, not the risk of failing to keep up with a benchmark
- The impact of bad days in global stock markets outweighs the impact of good days
- History suggests periods of suppressed market volatility, like 2016-9, are often followed by extreme dislocations

The investment industry is dominated by “fear of missing out”. It is well known that timing the market is a mug’s game. A lucky few might get it right once or twice in a career. Dinner party conversations, newspaper headlines and Hollywood movies are made about such heroic calls, in both directions, but market timing is not a reliable basis for long-term outperformance. Financial markets are simply too complex and reflexive to predict with certainty. But we can be confident that equity markets do rise over the long term. Therefore it is commonly argued that the only sensible strategy for long-term investors is to ‘buy and hold’ – invest once and ignore the noise.

What is more, although equity markets do go up over the long run, a surprisingly high proportion of their long-term returns come from a very small number of very strong days. The Financial Times ran an article a few years ago showing that an investor who missed out on the 10 best-performing days in the last 20 years would have had a 170% lower return than an investor who had remained fully invested in the FTSE All-Share Index at all times.¹ That conclusion is reinforced by our own work on the MSCI AC World Index over the last 30 years. If you had missed out on the best 10 days your return would have been 189% lower. If you had missed out the best 40 days you would have lost money (pre dividends):

MSCI AC World returns over the past 30 years – impact of missing out the BEST days



Source: Bloomberg.

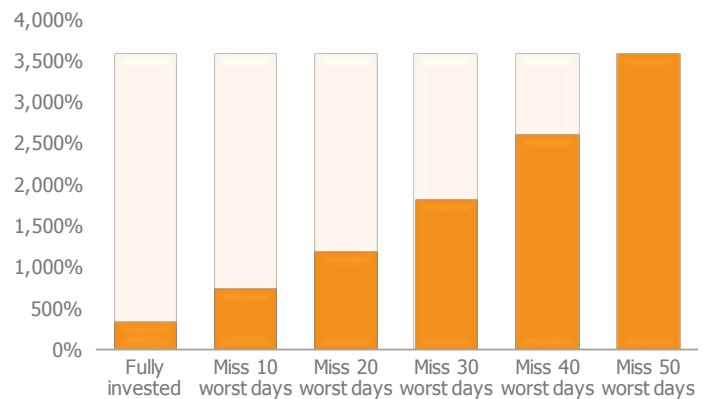
This kind of analysis reinforces the ‘fear of missing out’ among both professional investors and their clients. The overwhelming focus is on staying fully invested and keeping up with the benchmark.

¹Keep calm and stay invested” – Financial Times, 17 February 2017.

Markets go up by the stairs and down by the lift

Unfortunately the analysis is incomplete and therefore misleading. For a start, it fails to mention that the impact of missing the few worst days is even more powerful! Markets go up by the stairs and down by the lift. You would have more than doubled your return if you missed out the worst 10 days:

MSCI AC World returns over the past 30 years – impact of missing out the WORST days

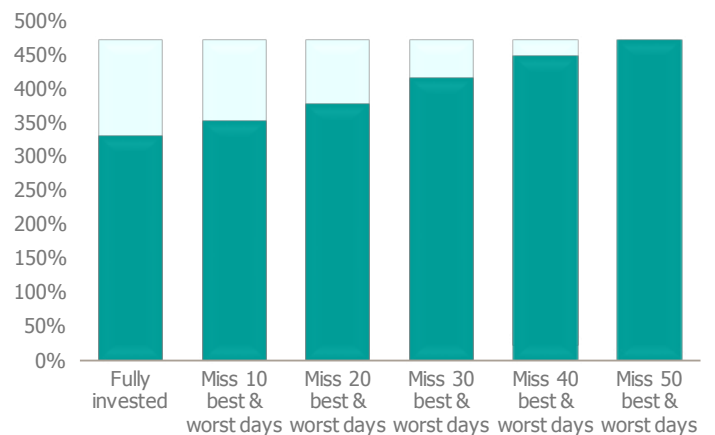


Source: Bloomberg.

Obviously neither of these scenarios is realistic. It is no more plausible to miss only the worst few days as it is to miss only the best. This is particularly true since the best and worst stock market days tend to cluster together, around particularly volatile periods. For example, the worst day in the last 30 years in global stock markets, 15 October 2008, came just two days after the best day. Six of the 10 best days and eight of the 10 worst days were in 2008.

It is (slightly) more realistic therefore to model missing out both the best and the worst days. And because the worst days have tended to be down by more than the best days have been up, the impact of this is positive:

MSCI AC World returns over the past 30 years – impact of missing out the BEST AND WORST days



Source: Bloomberg.

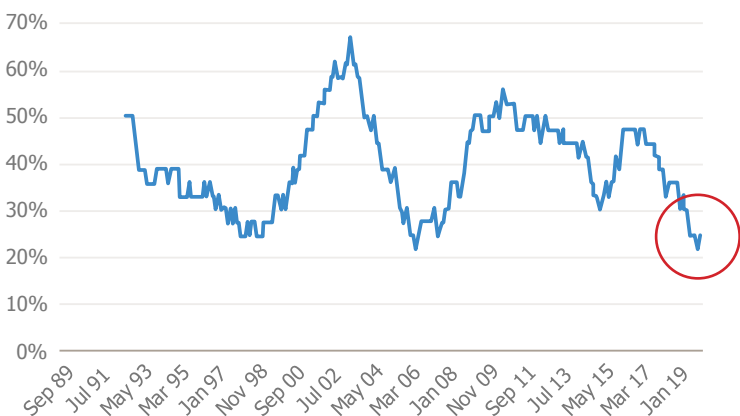
The conclusion is clear: fear of missing out and a compulsion to stay fully invested at all times regardless of the circumstances is detrimental to your long-term returns. It is just as heroic to insist on remaining fully invested as it is to stay completely out of the market waiting to time your entry right at the bottom. If volatile times are around the corner, far better to behave with prudence: invest in assets you understand and are confident will hold their intrinsic value through turbulent times, with some cash on the side available to take advantage of the opportunities created by volatility.

The curious absence of stock market volatility

Putting capital preservation first seems a particularly timely concept. After an August in which a small amount of volatility returned to equity markets, it is worth emphasising how unusually calm they have been in recent years and how unfamiliar it will feel if this changes.

One way to illustrate this is how few down months we have experienced in the past three years relative to history. Despite the fact that equity markets generally rise over the long term, their growth is far from steady. Stock markets do have more up months than down months, but not as many as you might think. On average, both the S&P 500 index since 1928 and the MSCI AC World Index since 1990 fell in 40% of months. Before the mid-1990s there was only one single three-year period when markets fell in only 25% of months: March 1948 to February 1951. Since the mid-1990s it has happened on three occasions: 1996-8, 2012-14 and 2016-19. In the three years to July, the MSCI AC World Index fell in only 22% of months, a proportion only previously seen in the three years to April 2006.

The calm before the storm? Percentage of down months in last 3 years: MSCI ACW Index since 1992



Source: Bloomberg as at 31 August 2019.

We do not believe that market volatility has been permanently reduced. Indeed, we strongly believe that suppressed volatility ultimately returns in a more acute form later down the line. **In that context, it is critical that investors retain discipline, guard against complacency and consider whether their fund manager fears destruction of their clients' money more than they fear missing out.**



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