

36 South Views

BY RICHARD "JERRY" HAWORTH



Take me to the river?

An equity price cycle is similar to the life cycle of rivers as they flow towards the ocean.

It starts as a small stream trickling its way down the hill. It grows in size and starts to meander as it does. Other streams join it and it becomes a strong, wide river with the odd little weir or waterfall along the way. At some stage it reaches a mountain range leading to a narrowing of its possible paths and it becomes a raging unstoppable torrent with rapids of immense power and momentum.

At its final stage, its power is dissipated as it reaches the delta or sea.

Equities are now in the raging torrent stage, fuelled by central bank liquidity, retail investor mania, passive investing and zero interest rates, just to name a few.

What do traditional portfolio managers do with such an environment?

Well it depends on what they feel their mandate is.

For most portfolio managers it means growing the portfolio... yield, return on assets at the lowest possible risk i.e. diversification. In which case their strategy is to enjoy the ride!

I believe the return mandate is too narrowly defined.

I believe that managers are (or should be) in the portfolio "RESILIENCE" business.

Make no mistake, growing a portfolio is just one way of making it more resilient i.e. the further you are away from zero, the less likelihood you will ever get there.

But it is not uncommon for portfolio managers to make returns at the EXPENSE of resilience. Like stripping a car of all its safety features just to make it go faster.

One can easily see how resilient a portfolio is by looking at a graph of potential performance over extreme market moves.

If it is concave, like an "n" it is not resilient. If it is shaped like a "u" or like a tick e.g. a tick in a tick box it is resilient.

A fast speedboat was the right vehicle for the calm meandering river, a robust "anti-fragile" white water specialist boat is now required if one is to survive the rapids and waterfalls to come. Your boat might go slower but it will get to the end without sinking.

"Resilience is the ability to attack while running away." - Wes Fessler

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