Valtrust Momentum September 2023:

Momentum manages risk in downturn and remains aggressive in upturns

One of the constant worries for an investor is the probability of a market crash. While this fear has existed ever since markets have existed, the fear has become more palatable post the great financial crisis of 2008.

In many ways, the last decade was an anomaly. At the beginning of the decade, even the most bullish investor did not expect the markets to run away, referring to the American markets here, as it did in reality.

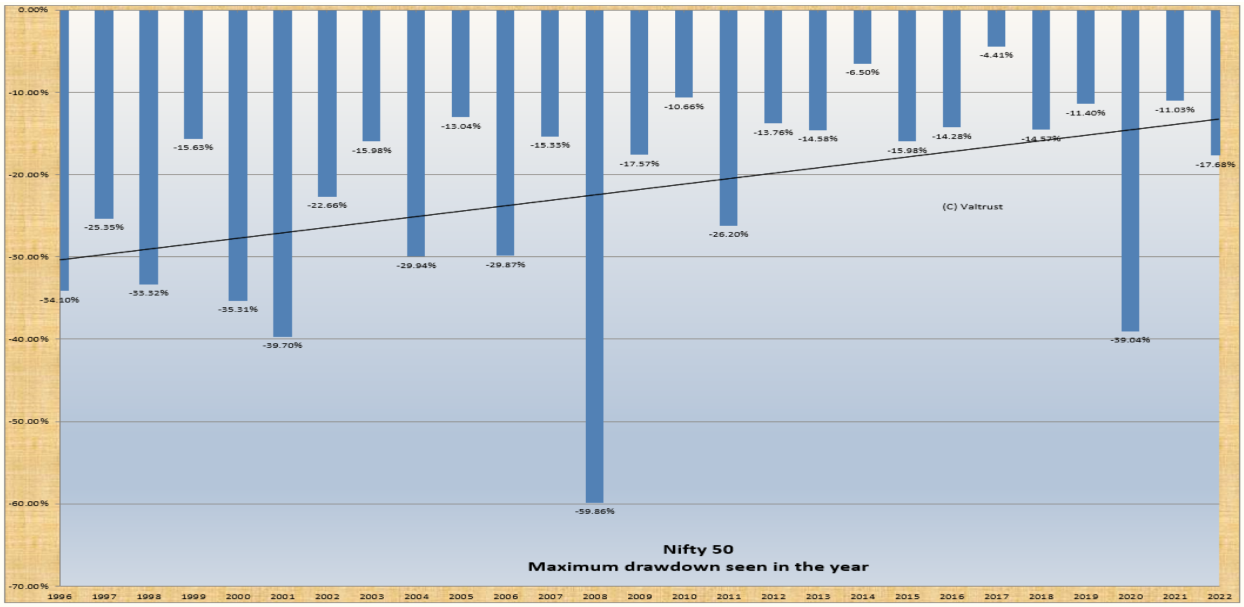
The biggest fear in the early years after the great financial crisis was the risk of hyperinflation thanks to the actions of the Fed which had expanded its balance sheet greatly. What happened instead was S&P 500 registering one of the best decades in a while.

"Prediction is very difficult, especially if it's about the future!" - Neils Bohr

The stock markets have evolved a lot over time. Corrections are part and parcel of the market but not every correction becomes a crash.

Take a look at the chart below. It shows the drawdown from the highest point reached by Nifty in the year to its lowest point post that high. Save for 2 years - 2014 and 2017, most years have seen intra-year corrections of 10% and beyond.

What is also interesting to note is the depth of drawdowns pre and post the great financial crisis. A 30% drawdown seemed fairly common and one that has become a rarity post 2008. There are multiple reasons for lower volatility, but key is the low interest rates that were seen across much of the world until recently.

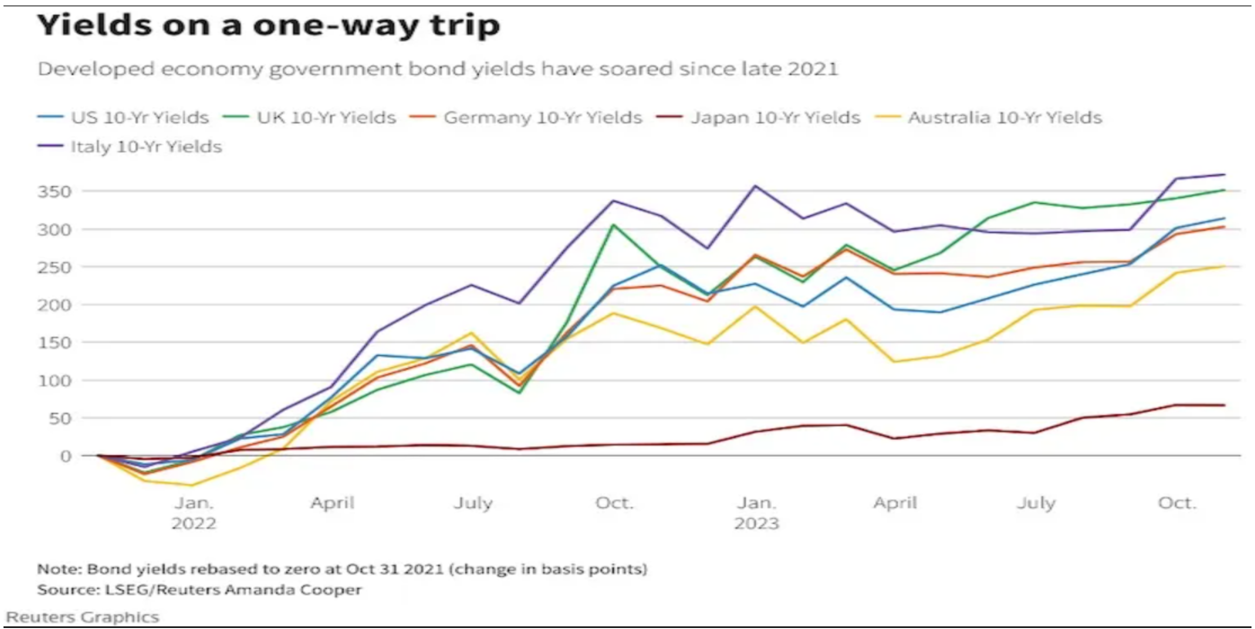


Fears of a deep drawdown accentuated by social media has driven the average holding period of stocks by investors down. In the United States, the holding period has dropped from around 7 to 8 years in the 60's to just a few months today. This results in suboptimal returns to those who try to get into cash at the first sign of trouble. A strategy such as Momentum avoids such landmines, thanks to it being not discretionary in either selection of stocks or position sizing.

Markets have risen quite a bit post the Corona crash with small caps leading the way in the last few months. But a rising market in itself doesn't signify or is a catalyst for a sharp fall. The sharpest falls outside of Black Swans like the 1987 crash or the Corona crash came post popping of a bubble. But how common are such bubbles?

In the book, Stock Market Crashes, the late Professor William T Ziemba along with his co-authors looked at historical evidence on bubbles. *Goetzman using the 1900 - 2014, 21 country equity markets data found that the chances that a market doubles gives back its gain is only about 10%. Markets are more likely to double again following a 100% doubling move*.

Interest rates in the developed markets have been on a tear in the last two years.



No one knows the implications. Historically, high inflation hasn't been a reason for a crash though they did lay the foundations for a crash in the future. We shall cross that bridge when we come to it.

Drawdowns are inevitable regardless of the strategy. The strength of Momentum strategy lies not in avoiding the unavoidable but managing risks during downturn while being aggressive in upturns.