Valtrust Momentum May 2024:

Beyond the Bull Market: Momentum strategy for Long-Term Investment Success

In the long term, say 10 years or more, the biggest contributor to stock returns comes from its Earnings. While there will be some small addition by way of the stock getting rerated, 80% or more in a liquid stock can be attributed to its own earnings.

In the short term, such attribution is much tougher. Sentiments for instance which cannot be measured have a greater impact than earnings. A stock that is seen as a good bet can go higher even when it announces a bad result. On the other hand, a stock where the future is seen as questionable sees a drop in price even after a good result.

If one were to see the Dow Jones chart from 1900 to date, the dip caused by even the great depression seems just a passing cloud. But for those who went through the depression, life was never the same. The impact has been seen in investor risk taking ability. Those born in the 1930's and 1940's have taken considerably lower risks vs those born in say the 60's and 70's.

Investing is a long-term game. Yet, it is played out in a time frame that is much shorter. The average lifespan of a S&P 500 company is now less than 18 years. The Index itself is rebalanced four times a year during which weak stocks are removed and strong stocks added. This ensures that the Index always continues to be relevant.

If one was invested in the Sensex at any point of time and held the investment for ten years, the only time he would be underwater was if he had invested in the peak of the Harshad Mehta led bull market of 1992. 10 Years later, we were in another bear market after the Dot Com bubble burst. Other than for that one instance, Sensex 10-year returns have been positive through and through. If one takes 10-year returns starting from 1996 (since Sensex itself was launched in 1986), the worst returns, of 5% CAGR, were for investors who invested close to the peak of the market in 2007 / 08.

But if one were to look around, there are very few successful investors. In many ways, it reminds one of the books "The Missing Billionaires" by Victor Haghani & James White. What are the sources of failure for investors and one that we should avoid?

In a bull market, the biggest fear of the investor is missing out on opportunity as everyone seems to reap windfalls. But when the tables turn, the fear of losing money makes the same investor get out at the worst possible time. This over time is called a Behavioral Gap which is the gap between fund returns and the investor returns. The best investors know that they cannot time the market and hence will always miss out on an opportunity or two. On the other hand, they also don't worry when markets go down because history has shown that in the long term, these too shall pass.

In a bull market, picking stocks by throwing darts or tossing a coin works. But to survive and excel in the long run, one needs to have a strategy that is Reproducible.

Momentum investing tries to overcome both the biases by one, not trying to time the market and go to cash at every fall. It also is a strategy that has been proven to work in markets around the world and hence not only a bull market wonder.