April 27th

Market Briefing

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"Stay focused"

Market briefing

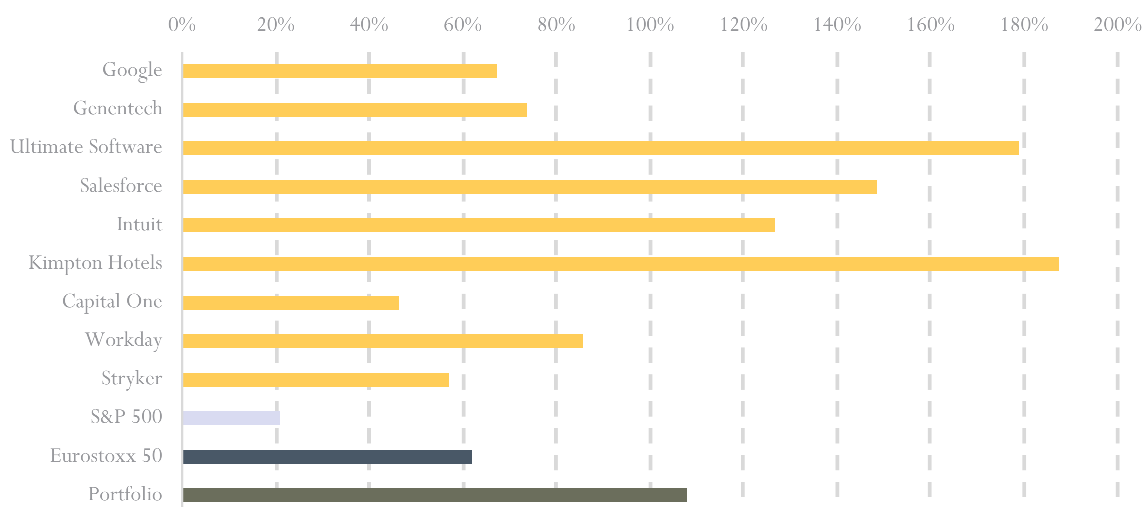
- Investors tend to choose a small number of factors when deciding what to look at when investing.
- The so-called "smart beta" approach is becoming very popular among a large number of investors.
- As it usually happens, a tool is as good as the use given to it.

Since the humanity was born individuals have been extremely good at discovering patterns. Some of these patterns have had a huge impact on the evolution of society. Take for example the ancient civilizations which improved their agirculture efforts by defining the pattern followed by the sun orbiting the planet earth. Focusing on one phenomena can represent a huge payout. Problem is the obrserver doesn't have a clue about the expected return of her effort until the discovery has been tested. And this can be very expensive as well as dangerous. The pattern recognition process implies matching pieces of information found in the surrounding environment with data already stored in the individual's mind. Once a pattern is recognized it can be assumed that it will go on indefinitely or that, as described by the Monte Carlo fallacy, there will be a return to normality.

Humans can, mistakenly, see patterns even in fully random processes.

Anyone who had taken a statistics course in University knows that if many statistichal tests are performed then a spurious relationship can be found, leading the observer to believe that two or more variables are causally related when in reality those are not. When it comes to stock picking investors tend to focus on a reduced number (even only one) of factors to use as the key variables on which ground their decision. This is what got the name of "smart beta". A valid argument can be "If employees are happy working for an organization then they will go the extra inch needed for the company to succeed.". Let's look then at the 2017 Fortune 100 list of Best Companies to Work For. Just looking at the first 20 companies we found that 11 of them are private companies (which can derive in another rule of thumb: If you are looking for a job better apply for a job at a private company) while 9 are publicly traded. Of those quoted in the stock markets all have had a positive return in the last five years. In the graph below we have compared the 5-year total return of the publicly traded companies (ranking within the first 20 companies in the Fortune list) with the S&P 500 and Eurostoxx 50 indexes returns over the same period. The result is quite compeling. A nine-stock portfolio, equally weighted to make things simpler, would have outperformed the market by far.

Just looking at a simple survey can help to build an awsome portfolio. Does it?



5 year return 2017 Forbes Best Companies to Work For

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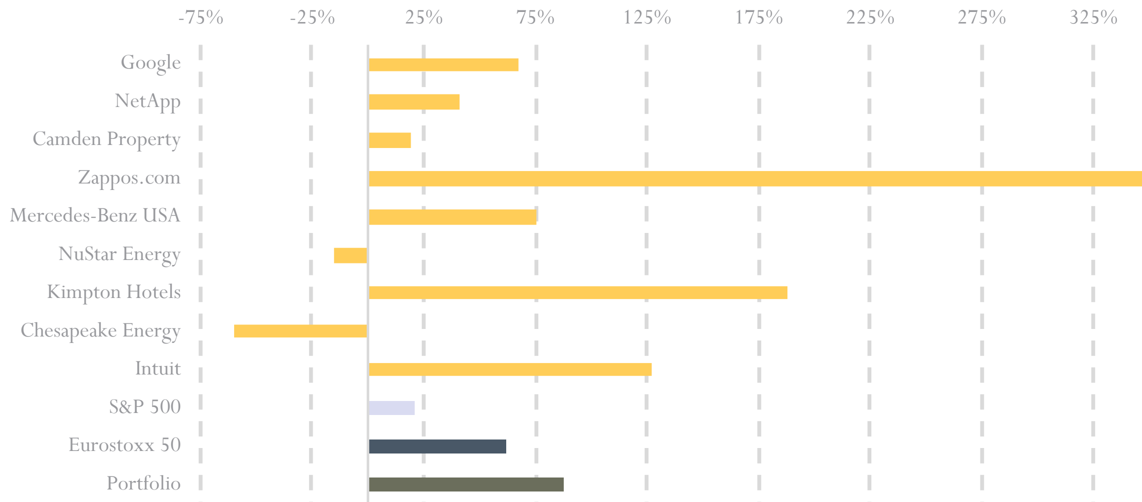
Tue, we couldn't have known five years ago which companies will be ranking today among the best companies someone can work for. We will go to that in short. Coming back to the graph in the previous page, it is needed to clarify that Genentech and Kimpton Hotels are subsidiaries of Roche and Intercontinental Hotel Group and consequently we have shown the evolution of the parent company's stock. Also, in the case of Workday, the performance evaluation goes back to 2013 which is the year the company started to be publicly traded. But even accounting for these details the results call for attention. What happened five years ago? Well, the 2012 Fortune 100 list of Best Companies to Work For does have, within its first twenty ranked companies also 11 privately owned companies and 9 ones which are publicly traded. The performance of these companies can be seen in the graph below. Some of them are also included in this year's list.



5 year return 2012 Forbes Best Companies to Work For

It is worth to note that the two companies with negative returns over these five years no longer belong to the list. Maybe the key is to keep an eye on which companies manage to hold a position. But even accounting for the negative returns of NuStar and Chesapeake this hypotetical portfolio built five years ago composed by these nine companies, equally weighted, is a good one.

Factors on which investors can see a pattern can range from something as mundane as the happiness of employees to more technical stuff like market size, momentum, dividend yield and volatility. Patterns are not a constant, but something we can infer from looking at data, lots of data.

The benefits of such a strategy will not show up immediately, and sometimes (assuming the pattern we are looking at is real) it may take years for the evidence to be on our side. There is also the mean reversion stocks commonly show, therefore we must be careful when looking at past returns if our approach is company based.

Thinking in a pattern as a train that passes by a station on certain intervals, we must avoid being on the track at the wrong time. Even being right a bad timing could mean we lose during the learning period. Looking at patterns, despite the results finally obtained, grants that at least our investment strategy will be coherent. Coherent to what depends on the pattern.

Having a strategy that is grounded to some objetive anchorage at least guarantees that if our belief is the right one we will profit from it. Within all the randomness implicit in any investment strategy having a constant, even if a cualitative one, may help even the less educated investor to have a decent approach when it comes to decide where to invest.

Beating the market is something worth of being proud of. Doing that on a recurrent basis is something you will tell your grandchildren. What seems to be ubiquitous is the need to have common sense whatever your strategy is.

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