THE Kingsmill Team

Macro views of the Market

Markets bump up and down ~ and yet, remain intact

Things I have learned listening to Robin
by Henry Pole, Guest Writer

In investing, we often hear the mantra '*buy low, sell high*'. It sounds easy enough: when the market dips and value is low, it's a good time to load up on shares. However, when we look at the market and we see that indecisive, green line plummet downwards, we can get tunnel vision. All we can see is the loss. The big drop. Many people panic and sell right here: when a share starts to lose value. They lose confidence the minute the market declines. They sell off their shares and only buy more when the market starts to recover. Doing this takes you out of the market at the most crucial time.

Growth: The long and the short:
You could think of growth as a competition. When the value of an asset goes down, it means it's falling behind. Just like a horse that isn't valuable after it loses a race, we sell off stocks for companies who can no longer perform. But consider this: investment isn't a short race but a long marathon.

The current value of a stock isn't as important as its long-term potential. How far can it take you? A company may be losing value now, but what does that actually mean? Will that company still be around in ten years?

What will your initial investment look like by then?

Market fluctuations are unavoidable, but the consequences of poor timing can be more damaging than riding out these ups and downs.

Market Declines: How scared should we be?
Research from the Capitol Group suggests that significant declines are more common than we think. Studying the S&P 500 Index from 1954 to 2024, we can see that dips of -5% happen twice a year.

-10% declines occur approximately every 18 months. Bear markets, a -20% decrease or greater, occur once every six-or-so years.

insights

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The market goes up and down all the time, and yet the US Stock Market remains intact. In fact, the market has remained at a steady incline for the past seventy years. Market declines are common. Instead of panicking every time we see the market go down, let's explore the potential.

Downturns in the market have historically been followed by eventual recovery and new market highs. So as serious as declines are, they often come with upswings in the market. If you sell when the market drops, you might not be able to afford to buy back in. The last thing you want is to miss the upswing.
To look at the graphs up close, dips seem catastrophic: nosedives. However, numbers can be presented in many ways. When you step back and take the macro perspective, you'll see a much different story; a story of success and stability.

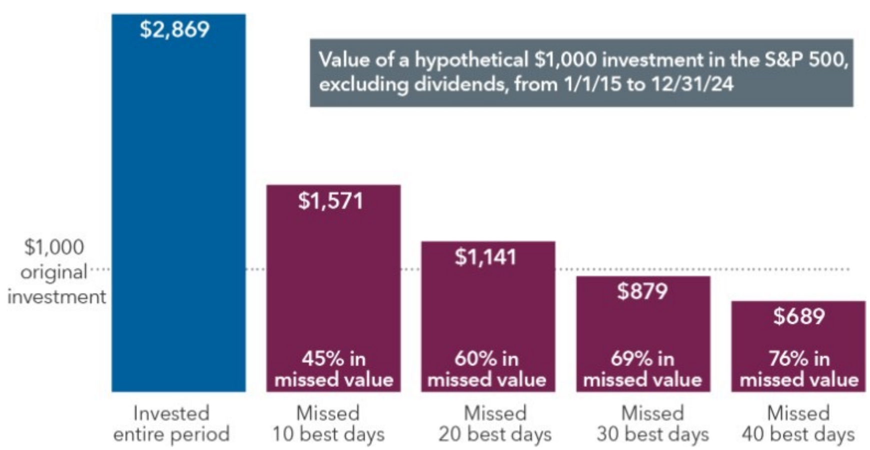
Market Timing: How much control do we have?

This graph from the Capital Group explores a hypothetical $1,000 investment in the S&P 500 from 2015 to 2024.

In this window, the investment totaled $2,869. That's a profit of $1,869. But that's only if the investment hasn't been touched for that entire period.

The next column shows the consequences of missing ten of the market's best days. Instead of $2,869, the sum has gone down to $1,571 - that $1,298 gone because of poor timing and the numbers only get worse the more days you miss. The best days offer the best rewards and missing them has huge consequences.

So, what makes people lose out on the best days? Selling before it's time.



Sources: RIMES, Standard & Poor's. As of December 31, 2024. Values in USD

The market goes up and down and conventional wisdom has investors pursue these fluctuations, selling when the market is high. Technically, this is a good strategy. You buy when the stock is cheap and you sell when it's expensive.

But there's more to the story.

The market's best days are days where the most profit is accrued. As we can see in this chart, missing ten best days is like halving your potential profits. Missing 30 or more? You've actually lost money. The problem is, it's impossible to say when the market hits its peak. We can only really know after the fact.

The good news is this: that $2,869 sum that we see in the first column (which, remember, is $1,869 in profit) comes from not doing anything. Instead of selling when we *think* the market is at its height, *we let it ride.*

We sell these stocks with the idea that we can buy back into the market later. But *when is* later? Is it after these best days? Are we missing these peaks because we think it leads to better profit?

If holding onto your shares during the best days garners more profit than selling when the market shifts, then trading on the ebbs and flows isn't the best solution. As much as we're trained to think that investing is high-risk, the best rewards come from patience.

If you can make more profit by keeping your shares, then why would you sell at all?

Market Value isn't Everything

Is it even half the story?

When we're trying to determine the value of a stock, we have to look at two figures: fundamental value and market value. Fundamental value is the worth of a company. Revenue, debt levels, cash flow and profit margin all contribute to the fundamentals. Market value is exactly what it says on the label: the value of a share in the market. This is mainly dictated by investor sentiment, supply-and-demand and general economic conditions.

In simple terms, Fundamental value is what a company or share is worth on paper. Market value comes in when it's time to buy or sell. Let's break it down further.

Fundamental Value:
Market value acts erratically, but a company's fundamentals are a little more consistent or, at least, more transparent.

When you're choosing companies to invest in, you want to think about the future. You want a company with strong fundamentals: healthy financials, strong leadership and room to grow. A company that has these things will take you far. Newer companies may not. Many younger companies, especially in emerging sectors like tech, may impress early on with strong growth and profits, but they can fizzle out quickly. Sure, they may have the market cornered now, but can they really compete when other businesses start to follow suit?
A company may be making good profits now, but what does that mean in the long run?

Are their profits being well invested? Are their earnings right now going to support them through transition periods?

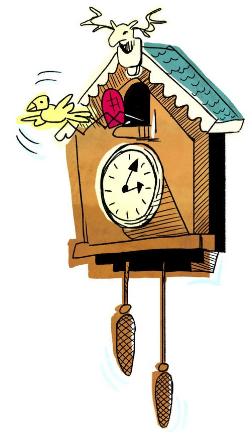
Blue chip companies have been around for a while. They have a proven track record, strong earnings and are among the biggest companies in their sectors. They're stable. If a company has lasted fifty years already, they're in a good position to last fifty more. Can you say the same thing about a tech startup?

Market Value:

Market value is typically described as the price an asset would get if it went up on sale. The price tag. But it's actually very complicated, based largely on investor sentiment and trends.

In many ways, the stock market is like an auction. A share in a company, just like an antique cuckoo clock, has been assessed and priced before it even gets to the block. This would be the fundamental value of it, agreed upon by experts. The auctioneer will announce the price, if you can parse his fast-paced patter, but that isn't the final price by any means.

A woman in the front row raises her planchet and makes a bid at the opening price. She's outbid by someone else in the crowd. Now the price of the stock, or the cuckoo clock in this case, has gone up. Another bid comes in. Then another.



Soon there's a bidding frenzy, with everyone in the crowd wanting a piece. The problem is, there's not enough of the asset to go around. Not everyone can win and so nobody wins, really. Even the person who puts in the final bid has well exceeded the fundamental value of the asset. If everyone's fighting for a piece, you're never going to get a good deal.

Conversely, that asset might be worth a lot, but if nobody wants to buy it (maybe cuckoo clocks are out of fashion) then that price doesn't mean much. And so there you have the stock market: supply and demand.

If there are more shares than people who want to buy them then the value goes down. If there are more people who want to buy in on a company than there are shares to sell, the value goes up. All you see are numbers on a screen, but there are lots of people trying to buy in. We're just sitting in a crowd, hoping to get the final bid.

Determining Value

Valuation: Over and Under:

Just like the antique Cuckoo Clock, investors are hoping that the value of an asset will go up. Nobody *tries* to buy stocks that will be worthless by the time they're ready to sell. Market value reflects what a company *could* be worth, but it's just an estimate.

Value is what investors predict a stock will be worth in the future. As such, there is a gap between market value and fundamental value. It's room to grow. The company should continue to grow so they can fit this size.

A company will make money - that's what they do. But how long would it take them to make the money to buy their shares back at their own Market Price? How long would it take them to afford going private? Four years, or forty years?

If a company can make enough money to afford its market value in a short time period, that's a pretty good sign. If a company would take forty years to meet its own price tag? Well, that's not so much an issue with the company as with its valuation.

Bubbles and Boondoggles:

There are many companies who find themselves in a *value bubble*. This happens when the market value greatly overshadows a company's future potential.

You'll often see this in the tech sector. New technologies often provoke high valuation, making it impossible for a company to deliver on these lofty expectations. The value of their shares is inflated by an eager market. Their supposed worth is far greater than their actual ability to earn and grow.

…a situation that is inherently unstable.

A bubble occurs when a company is so overvalued that they can't meet their market valuation. No matter how much money they make, the valuation is so over-inflated by hype and excitement that the company can never live up to these expectations. They've been terminally overvalued.

That being said, overvaluation doesn't always mean that there's a bubble.

As long as that company can make their fundamentals meet their market value, then there is no bubble. There are many companies that are expensive to invest in but, through innovation and strong leadership, they can close the valuation gap.

The gap will inevitably close. A company will either perform poorly and investors will lose faith, driving the share price down, or a company will perform well and their fundamentals will move to reflect their market value. The gap will always close.

Alternatively, we can get undervalued companies. This happens when the market loses faith in a company before it's time. They sing a funeral dirge while the company is still alive and making money. But just because the market's turned its nose up at a company doesn't mean that it's worthless. They still have their fundamental value.

As long as a company can keep growing and keep making profits, they're not dead - no matter what the market says.

Investing with a Clear Head:

Chasing market value is just like chasing trends - it's great if you want to seem hip at dinner parties, but it'll be irrelevant next year. Looking for reliable companies with consistent earnings and strong growth potential will help your portfolio remain timeless.

How can we expect the complexities of business to be captured by something based entirely on public sentiment? Being aware of a company's intrinsic value will help you to predict its future possibility. Market value is crucial (how can you expect to sell without a market) but it's just one factor.

Smart investors look at more than just the ebbs and flows of the market: they look at the investment itself. A company with strong fundamentals will continue to grow regardless of what's going on in the market.

By understanding the gap between Market Value and Fundamental Value, we can make more informed choices about investments. We want to future-proof our investments as best we can. Searching for companies with good fundamentals offers greater stability. Buying when the market is low offers more control. Play offence, not defense. When the market changes, which it will, you want to be ready for it. You want to use its ups and downs for your own advantage.

In a bad market, even bad stocks will be expensive.

Successful investors look for something that will continue to appreciate in value for the years to come, not something that they have to sell off by the end of next quarter.

So, how do you know when a company is in an overvaluation bubble? How can you tell if a stock will continue to perform well? How do you know when it's time to buy or sell? That's where analysis comes in.

Pooling together the best research in the western hemisphere; Market analysts from the US and Canada, including the award-winning team here at Nesbitt-Burns, The Kingsmill Wealth Management Team can rely upon their insights on the market and on specific stocks. Their research is much more sophisticated than what you might hear on the news or at your neighbourhood barbeque.

That's how you give your portfolio the edge. It's may be expensive research, but it is worth every penny, and more.

You should know: