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This update is provided by Independent Accountants' Investment Counsel Inc.

Investment Strategy During Market Downturns

In the midst of the current coronavirus outbreak, economic upheaval and market volatility, we are often asked by our clients about our buy-and-hold investment strategy and what work we do during the downturn.

Here are two commonly asked questions:

Q1 - Why would you not exit the stock market at the start of a recession and jump back in at the onset of economic recovery?

As noted in a recent report, an investor with perfect forecasting ability who accurately predicted the start and end of every recession since 1928 and moved to cash to avoid the economic downturns would have earned a compound average annual return of about 10.7% per year. This compares to 9.5% for a buy-and hold-investor. So certainly a better return than buy-and-hold but not by much – and we know of no economist or forecaster who has predicted every recession with such accuracy. The long-term results are still very attractive without this “perfect knowledge”.

Part of the reason the “perfect knowledge” investor did not fare significantly better than the buy-and-hold investor is that the stock market does not follow the economy perfectly. During the financial crisis of 2008-2009, the S&P 500 hit bottom in early March 2009, whereas the recession officially ended in June 2009 (according to the National Bureau of Economic Research). By June, the S&P 500 had already increased by 41.4% from its lowest point. It would have been a shame to be an investor who was waiting for the economic recovery to begin before investing back into the stock market.

Q2 - Why not get out of the markets now and jump back in later?

When will the stock market hit bottom during the virus outbreak? We believe it is impossible to know when we’ve arrived at the “bottom” of any market decline.

Warren Buffett, one of the most successful investors of all time, penned an op-ed in the New York Times on Oct 16, 2008 during the financial crisis. He revealed to the world that he had begun buying US stocks in his personal account. That day, the S&P 500 stock market index was down about 42% from the highs reached in the fall of 2007. The market did not actually “bottom” until March 6, 2009, almost five months later and another 27% lower from the levels prevailing when Mr. Buffett first started buying back in. Warren Buffett clearly saw value at the prices that were present during the market decline and did not wait to act – he didn’t try to guess when the market was going to arrive at its bottom.

The idea of getting back in “later” also causes many unforeseen problems that will force investors to once again abandon any anchor on fundamental valuation. Will an investor have the courage to invest if prices fall even lower? Certainly, the panic and fear will be higher at that moment, making it even tougher to ignore the emotional impulse to “wait” some more (after all, it paid off last time). If investment decisions are not based on the valuation of the underlying securities, what exactly would the marker be that you would use to decide that “now” is the perfect time to buy back into the market?

How We Navigate Volatile Markets Like These

There are certain conditions that historically occur during a “bottom” and many of these markers are present today. However, there can be no way to know in advance if the market has reached its “bottom” until well after the fact.

We focus on valuation, fundamentals and facts. Information is flowing every day and we remain focused on assessing the impact on the value of our core picks and their long-term prospects. We do not believe the intrinsic values of great businesses are fluctuating nearly as much as price these days. We continue to scan the markets for additional opportunities to grow our core pick list of ideas. It is markets like these that can create dislocations between price and value.

Making reasonable estimates of value is still possible, even in these markets. Comparing prices to these calculations of value is the best investment idea that we know and is one that works over a long period of time.

And that is what we are focused on. This is the strategy we employ every day for our clients.

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