Herald-Journal

Noel Swain: Following the Herd

Published: Wednesday October 17, 2018

We are creatures of habit, aren't we?

We are also creatures of the herd mentality. If we do what everybody else does, we might be wrong, but we won't be alone.

When the 2008 market meltdown happened, people lost 20 percent, 30 percent, 40 percent or more of their hard-earned wealth. Every investor was down.

The market hit its lowest point on March 9, 2009, and then started a climb that is still going on.

It's experienced three minor corrections of just over 10 percent in the nine years and seven months since the market started its current climb. The longest-ever bull market is still going on.

Because of that, passive investing – buy and hold – has way outperformed active investing, or buying and selling, during that time. Because of the high volatility in 2009, actively managed accounts sold twice as much as passive accounts, about $300 billion to $150 billion, according to Catalyst Funds.

Now that everything in the market has been bopping along with few hiccups, passive out-sold active investments $600 billion to nothing last year. Active investments have actually had net outflows for the last three years. Is that short-sighted?

When – not if, but when – the market turns down hard, and those passive investments start hemorrhaging money, active investments may still maintain all or most of their value. At least that's what they are designed to do.

When this happens, there will be lots of people who will lose 20 percent to 40 percent of their value, just like they did in 2008 and early 2009. Many will swear off the stock market forever, blaming it for taking away their financial security.

My profession will also be culpable. The vast majority of us do what our clients do: We project what an investment recently made into the future. While selling our clients passive, and very expensive, investments is legal, it's also lazy – or incompetent – because nothing is easier than saying to our client, "Well, Mr. Client, the Gronsky Mid-Cap Value fund made 27 percent last year. I'm sure you want some of that, don't you?"

That's looking back at the recent past performance of that investment and projecting it forever into the future. Had the "advisor" looked, he or she might have seen that mid-cap value investments had fallen out of favor and were now trending down. Because of that, mid-cap value funds may be losing value, not making the great returns they made last year.

I believe it is important to closely follow the trends of the market and vacate the sectors that are currently trending lower.

It takes time and effort to stay on top of it, but the rewards can be very satisfying. Buying the overall stock market and holding it for 30 years can be a good idea for intergenerational wealth. But most of us are just trying to invest so we can retire at the normal age and stay retired.

Having some downside protection along with the growth potential only the stock market can give you is the great idea behind active management.