



PRATO CAPITAL

DÉJÀ VU ALL OVER AGAIN

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INVESTMENT FADS ARE NOTHING NEW. WHEN SELECTING STRATEGIES FOR THEIR PORTFOLIOS, INVESTORS ARE OFTEN TEMPTED TO SEEK OUT THE LATEST AND GREATEST INVESTMENT OPPORTUNITIES.

Over the years, these approaches have sought to capitalize on developments such as the perceived relative strength of particular geographic regions, technological changes in the economy, or the popularity of different natural resources. But long-term investors should be aware that letting short-term trends influence their investment approach may be counterproductive. As Nobel laureate Eugene Fama said, “there’s one robust new idea in finance that has investment implications maybe every 10 or 15 years, but there’s a marketing idea every week.”

WHAT’S HOT BECOMES WHAT’S NOT

Looking back at some investment fads over recent decades can illustrate how often trendy investment themes come and go. In the early 1990s, attention turned to the rising “Asian Tigers” of Hong Kong, Singapore, South Korea, and Taiwan. A decade later, much was written about the emergence of the “BRIC” countries of Brazil, Russia, India, and China and their new place in global markets. Similarly, funds targeting hot industries or trends have come into and fallen out of vogue. In the 1950s, the “Nifty Fifty” were all the rage. In the 1960s, “go-go” stocks and funds piqued investor interest. Later in the 20th century, growing belief in the emergence of a “new economy” led to the creation of funds poised to make the most of the rising importance of information technology and telecommunication services. During the 2000s, 130/30 funds, which used leverage to sell short certain stocks while going long others, became increasingly popular. In the wake of the 2008 financial crisis, “Black Swan” funds, “tail-risk-hedging” strategies, and “liquid alternatives” abounded. As investors reached for yield in a low interest-rate environment in the following years, other funds sprang up that claimed to offer increased income generation, and new strategies like unconstrained bond funds proliferated. More recently, strategies focused on peer-to-peer lending, cryptocurrencies, and even cannabis cultivation and private space exploration have become more fashionable. In this environment, so-called “FAANG” stocks and

concentrated exchange-traded funds with catchy ticker symbols have also garnered attention among investors.

THE FUND GRAVEYARD

Unsurprisingly, however, numerous funds across the investment landscape were launched over the years only to subsequently close and fade from investor memory, as shown in Exhibit 1. While economic, demographic, technological, and environmental trends shape the world we live in, public markets aggregate a vast amount of dispersed information and drive it into security prices. Any individual trying to outguess the market by constantly trading in and out of what's hot is competing against the extraordinary collective wisdom of millions of buyers and sellers around the world.

It is important to remember that many investing fads, and indeed, most mutual funds, do not stand the

Exhibit 1

Few Equity Funds Have Survived and Outperformed

Performance periods ending December 31, 2017



The sample includes funds at the beginning of the 5-, 10-, and 15-year periods ending December 31, 2017. Survivors are funds that had returns for every month in the sample period. Winners are funds that survived and outperformed their respective Morningstar category index over the period. US-domiciled open-end mutual fund data is from Morningstar and Center for Research in Security Prices (CRSP) from the University of Chicago. Past performance is no guarantee of future results.

test of time. A large proportion of funds fail to survive over the longer term. Of the 1,622 fixed income mutual funds in existence at the beginning of 2004, only 55% still existed at the end of 2018. Similarly, among equity mutual funds, only 51% of the 2,786 funds available to us-based investors at the beginning of 2004 endured.

With the benefit of hindsight, it is easy to point out the fortune one could have amassed by making the right call on a specific industry, region, or individual security over a specific period. While these anecdotes

can be entertaining, there is a wealth of compelling evidence that highlights the futility of attempting to identify mispricing in advance and profit from it.

WHAT DO THESE STRATEGIES OFFER?

When confronted with choices about whether to add additional types of assets or strategies to your portfolio, it may be helpful to ask the following questions:

1. What is this strategy claiming to provide that is not already in my portfolio?
2. If it is not in my portfolio, can I reasonably expect that including it or focusing on it will increase expected returns, reduce expected volatility, or help me achieve my investment goal?
3. Am I comfortable with the range of potential outcomes?

If you are left with doubts after asking any of these questions, it may be wise to use caution before proceeding. Within equities, for example, a market portfolio offers the benefit of exposure to thousands of companies doing business around the world and broad diversification across industries, sectors, and countries. While there can be good reasons to deviate from a market portfolio, you should understand the potential benefits and risks of doing so.

Conclusion

Fashionable investment approaches will come and go. Successful investment outcomes for our clients here at Prato Capital Management all begin by creating and following a Financial Life Plan that fits your needs and risk tolerance. Having a *Plan* that incorporates a globally diversified approach to investing while staying disciplined through market volatility can help improve your chances of achieving your long-term financial goals.