

Wednesday, October 19, 2022

THE BUSINESS TIMES

INSIGHTS FROM CFA SOCIETY SINGAPORE

Witch of October is here: Short-term pain leads to long-term gain



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able to panics.

Even after the United States transitioned to an industrial economy and re-established a central banking system in the early 1900s, the memories of past Octobers seem to have conditioned investors to erupt in panic out of habit. October 2022 may be just the latest manifestation.

Costs of closet tactical allocation

Panic is the mortal enemy of long-term investors, especially in volatile markets, but that does not mean that we should sit idly by in the face of another October scare.

At times like these, the late David Swensen's observation in his classic *Unconventional Success* is worth remembering: "Perhaps the most frequent variant of market timing comes not in the form of explicit bets for and against asset classes, but in the form of passive drift away from target allocations."

Many investors fail to heed this advice at the very moments when it is most valuable. Instead, they let their gains ride in bull markets and then freeze up when markets descend into bear territory. This is

October's shadow

Dow Jones Industrial Average's 10 worst days

DATE	ONE-DAY DECLINE
Oct 19, 1987	-22.6%
Oct 28, 1929	-12.8%
Oct 29, 1929	-11.7%
Dec 18, 1899	-8.7%
Mar 14, 1907	-8.2%
Oct 26, 1987	-8.0%
Oct 15, 2008	-7.9%
Oct 18, 1937	-7.8%
Dec 1, 2008	-7.7%
Oct 8, 2008	-7.3%

Source: Dividend.com

precisely the insidious form of tactical asset allocation referenced by Swensen.

But history shows that this is never wise. For every savant who successfully traverses the treacherous macroeconomic currents, many more suffer financial ruin while making the attempt. Failure to rebalance may not be ruinous, but it will almost certainly drag down long-term returns.

So, why is such tactical asset al-

location so common among pension funds, foundations, endowments, and other institutional investors? Since many are advised by non-discretionary investment consultants who lack the authority to rebalance portfolios, they simply neglect to advise their clients to do so. But trustees need to take the initiative and ensure that they follow through on rebalancing during times like these.

Short-term pain and long-term gain

In *Principles*, Ray Dalio advises readers to seek painful feedback so that they can confront their deficits and attain the insight necessary to eliminate them. He often repeats the mantra: Pain + Reflection = Progress.

Economic events follow a similar principle. Today's economic pain will likely intensify in the coming months, but that doesn't mean that we suffer needlessly. The mistakes of the past must be corrected.

Elevated inflation has persisted for too long, and re-establishing price stability is absolutely essen-



Traders working on the floor of the New York Stock Exchange in September, when the DJIA dropped 400 points. Historically seven of the 10 worst trading days in the US stock market occur in October. PHOTO: AFP

tial to ensure future economic prosperity. We learned this in the 1980s. There is no need to learn it again in the 2020s. We have to break the back of inflation, and while that will be painful, it will be worth it.

Today's hardships will not be for naught. After the recession of 1981 and 1982 subsided, the US economy came back stronger. Fuelled by extraordinary technological innovation, the country went on to enjoy two decades of economic prosperity.

The past two and a half years

have had plenty of financial scares. We may see more this October and in the months ahead. But when it passes, we will breathe freely again. In the meantime, we need to steel our nerves, rebalance our portfolios, and trust that the pain we suffer now will be rewarded in the future.

The writer is a seasoned investment adviser, serving large institutional investors, such as endowments, foundations, public pension plans, and corporate operating reserves.