

Holland Macro Views

Market Cycles, Feedback Loops and Echo Chambers

Investors may well be reflecting that one new risk just seems to come straight after another. First it was Brexit, then Covid, then the rising cost of living/interest rates. Now there is war in Ukraine. Whilst seeing the same headlines you do we find ourselves wondering if they have a common theme and whether we should alter the way we think about market cycles.

[Three different cycles](#)

As investors we are forced to think about cycles and in the past I have written that I think there are three distinct ones. These being the **political** cycle, the **economic** cycle and the **stock** (and credit) market cycle. The first one often dominates our news wires with political infighting seemingly never ending, the second is one many hours are spent fruitlessly trying to predict. The final cycle we observe is the stock (and credit) market one. It receives less attention, but often we think over time it affects investors far more than the other two combined. The best observer of market cycles by far is Howard Marks and his [books](#) and letters on this subject are must reads to all interested in this area. However a combination of recent events have us thinking whether even Howard Marks' view on this subject might need refining.

[Investing is not a profession](#)

The other claim we have made before is that investing is not a profession, even for “professional investors”. There is no pun in this, we think this a serious observation. For us examples of professions are doctors and engineers. This can be evidenced by the fact that their industries learn by their mistakes and as a result these outputs (products built and care provided) improve over time. NB: It has been a while since any readers will have driven over a new wooden bridge or thankfully been treated with leeches (poor George Washington was). Investing is full of hard-working individuals, but ones that learn by their own mistakes rather than from past generations. In that it is perhaps similar to politics where decisions are made with the best of information at the time, and hopefully the best of intentions. But those decisions are as likely to be correct as those made by our fathers or grandfathers generations – no better. Whether political or investing decisions are right or wrong takes a while to find out. In medicine thankfully many treatments are highly successful very quickly.

[Our job](#)

Our job is to protect capital and hopefully make it grow by its well-considered deployment. To do so effectively we also have to balance opportunity vs risk. Sometimes this process feels simple enough. At others, particularly during periods of intense change it can feel highly complex. In order to do this we have to think broadly and often in a contrarian manner in opposition to current trends.

“Research is formalised curiosity. It is poking and prying with a purpose” Zora Neale Hurston

[Recent reflections – A global echo chamber](#)

Conducting our research against the backdrop of the last few years is causing us to make a few new reflections about market cycles. The investor sentiment pendulum often described as swinging between greed and fear paints a helpful picture, but one of a slow gradual movement from one extreme to another. It also suggests the existence of single pendulum that represents widespread collective investor optimism or fear. This is a nice neat image and helpfully describes how some investing cycles have transpired (say the 2007-2011 period). However recent events paint a different picture. This suggests multiple overlapping sub-cycles of peak and fear. Also that extreme positions that once took time to establish are achieved more quickly. The main reason for this we see is the echo chamber between public opinion and public policy.

[Things happening quickly](#)

We cite a few examples. Some of these happened outside the investment sphere and some within it. A few maybe all can relate to are listed below:

- **Brexit**
- **The Trump/Capitol Hill storming**
- **Covid-19** Whilst all with have different views on this we think it evidential that some governments changed their planned reaction to C-19, in reaction to peer country pressure and public feedback.
- **Ukraine** The most recent example we suggest is Ukraine. In almost all past wars or invasions global populations have not reacted in the same way as they are doing today. Responses were mostly left in the hands of political and military leaders with those responses then explained to wider populations.

The strength of feeling that both C-19 and Ukraine have elicited in billions of people is something to perhaps marvel at. People are engaged, they care and they want something done. If looked at through the eyes of a democratic process this is wonderful as it is real time democracy and real time political accountability. However as observers of not just cycles but also the human emotions that can often drive them, we think it worth noting that this is new. Maybe we are falling into a recency bias here, what we are sure of is that politicians are being led by public opinion more than ever. With public opinion able to change very fast those politicians that like staying in power tend to want to change with it.

We must be clear we are not saying this is right or wrong, only that it is occurring whether we like it or not. A few points stand out:

- We are not lovers of executive power, but we are prepared to accept that sometimes world problems are hard to solve and might require time and tact. If the mob is shouting to do more and do it now that could make some situations harder to deal with.
 - With this in mind there may well be well informed advisors that are looking at the second order consequences of actions which populations cannot foresee
 - As long as popular opinion only informs policy rather than dictates it, the influence is likely a good one
- **Hard medicine.** Sometimes, such as in the fight against inflation, policies are brought in which are against almost everyone's best interests. How might these actions and those that enact them be perceived in a new world of echo chambers and daily accountability? We note the criticism that Jay Powell received from President Trump at the hint of rising interest rates a few years back.

[An investment echo chamber](#)

We observe that similar things are also happening in a world we know far better – that of investing.

The growth vs value debate has existed for years, but the ‘pay any price for growth and quality’ ideology certainly seemed to gain a life of its own until very recently. Was an echo chamber of people all agreeing with each other re-enforcing this idea? Looked at in isolation we would be inclined to conclude “maybe yes, but is this really anything new?” having witnessed 1999/2000 first hand.

“The more imprudence with which others conduct their affairs the greater care you should take with your own.” **Warren Buffett**

However we have now also seen arguably an even stronger ideology get behind ESG investing as well. It is not that we are against or for either of these ideas as we think all routes to investing can be considered. It is the fervent belief that many supporters bring to these ideas and the need they have for others to comply. This stops important debate in its tracks. There is seemingly a requirement for many institutions to quickly adopt the right/compliant message. We are just worried that many investors are forced to comply either too willingly without thinking about the contrary viewpoints or unconsciously as they react to echo chambers full of similar views. There is a danger that this is just extremism by another name. We are not saying that ESG investing say is right or wrong, but just asking the question as to whether the pressure to comply might cause some to make irrational conclusions/allocations of capital. We are mindful that for most people career/reputational risk trumps all other risks including that posed to other people’s capital they might be custodians of.

“The road to hell is paved with good intention” **Proverb**

[The best holder of your moral compass is... You](#)

Many recent new rules or guidelines on what some investors can/cannot invest in illustrate this point. We are not talking about the ban on trading in Russian securities which is a reasonable policy during a conflict that all investors should be not just happy to comply with, but supportive of. We refer instead to the guidelines that were recently being pushed hard by policy makers and pressure groups to investors. These included not to invest in hydrocarbons or defence until only a few short weeks ago! If there are benefits and possible drawbacks of popular opinion getting involved with Government policies the same can be said for their involvement in capital markets too. The importance of capital market cycles and the freedom to chase them or invest when others are not has been a mainstay of the free market for decades. It should not be interfered with. The best investors understand this, but feedback loops of public opinion and overzealous compliance departments can make it hard for good investing contrarians to keep performing their roles. A real life consequence of this conflict can be seen in today’s \$110 oil price. Investors should never tell policy makers how to do their jobs, but the reverse is also true.

“Our job is just to navigate the world as we see it not as we would like it to be” **Rupert Soames**

[What is happening and why](#)

It looks to us as if we need to consider multiple market pendulums – some at different points to others. Equally we also need to be aware as we have seen in these last few weeks that in this modern world things can change very fast indeed. Partly this is driven by events as it always has been, but also now by possible escalations as a result of public opinion and the feedback loops they can bring. We are open-minded in that such escalation could be a good thing (as the pressure to assist Ukraine looks to be). But we are minded to be aware it might not always be. That politicians are following not leading *may* also be good, but again there may be consequences down the road.

The 'why' looks to be due to global communication, with the availability of it and in particular social media to almost all. News is no longer presented to the public as the fait accompli it might have been in the past courtesy of the BBC World Service. Instead, it is an unfolding live event that can be interacted with. These interactions in turn can help policy makers decide what to do, if they seek to please or appease those that elected them. This call to swift action as we have stated above can be good if the actions turn out to be correct ones or bad if they are not. As we stated at the outset: investing and politics are not professions. Sadly, likely as many mistakes are made now as might have been made in the past by those within them. The only difference is maybe that today's policy makers *think* they have greater support.

What should we as investors do differently as a result?

Maybe very little is our answer but we think just being mindful of what we describe above might help us to frame future events. We also think:

- Investors now need to think in multiple market cycles in different segments of market. So Growth vs Value might be a point X on one pendulum, but ESG compliance at point Y and so on...
- Also investors need to be aware of how quickly views can now change and then be extrapolated and re-enforced at the policy level if they gain traction
- Investors should try to have a strong views of their own on ESG/corporate governance being clear on what matters to them and what does not
 - We note that investors like Buffett have arguably been investing ethically for 50 years, but have managed to do so without a long and complex rule book

Owner Manager – Heroes or Pariahs?

Whilst unconnected to macro events we think we have seen some of the extreme thinking we describe above in some of the shares we research. Despite the efficiency of modern markets the occasional company can show both great prospects and yet be deeply undervalued. Those that do are likely in either a hated or neglected sector or labelled as pariahs, where no matter how cheap the shares are no one is interested. Examples of this we feel today are Frasers, J D Wetherspoon and Boohoo. Many institutions complying with some ESG guideline have convinced themselves that these companies are un-investable having fallen foul of some rule or other. In contrast to other companies that might pass such tests we think these companies' founders are passionate about their businesses, passionate about their customers and loyal to those that work for them. They are proud to grow and employ more people as they do. As such businesses are neglected by those with rulebooks we are opened minded and excited about the opportunity they can offer.

Sometimes such owner managers are presented as villains or untrustworthy grave robbers. Most in the investing world can see the care owner managers have for their businesses. Some founders may be unconventional and not keen to court public opinion, but that does not mean they care any less than Messrs Bezos or Buffett do. There are other types of owners of business who, in aggregate, are far less good custodians. The best example being private equity! That many asset allocators will invest in the latter while avoiding some entrepreneurs shows they are far more influenced by what they read in the papers than they might like to admit.

Social Media – Genies and bottles

Charlie Munger tells us to solve problems by inverting them. As such do we think the feedback loops and echo chambers we are observing in this piece would be occurring without modern mass communication? No. Is social media the most powerful of these communications? Yes.

This conclusion was reached by many that observed the Capitol Hill storming in January last year. Seeing these platforms as facilitators they challenged them to improve who can/cannot communicate on them and about what. Those same platforms however will have helped billions learn from each other during Covid-19 and many in Ukraine importantly communicate with the outside world. They have also helped Western policy makers see the strength of feeling towards Ukraine and respond accordingly with the speed that accompanies conviction.

Indeed if a country now turned off such platforms to control speech it would be likely reported as censorship. We suggest that social media platforms should be seen by all for what they are – part of the communication global daily life, for better or worse. They are genies that cannot be put back in bottles, and the global population enjoys using them a great deal for many different uses. Which of them grows faster or slower in both consumer popularity, use for utility and thus value is hard to predict, but large powerful networks used by billions we think will have high values many decades from now.

Metcalfe's law states that the value or utility of a network is proportional to the square of the number of user's of the network (n^2).

In closing

I have been employed to analyse equities and markets since the summer of 1987. As such I have seen a few cycles come and go. I have also learnt a great deal from studying those older and wiser than me. In aggregate, I would observe that the skill/craft required to navigate market swings are little different from those needed 30 years ago. The reason being that the job, as once described by John Templeton is as much about a 'good stomach' as a 'good brain'.

That said I think it is important for any and every investor to always be looking to learn and refine their process. This may relate to how they think about business models or the company managers they entrust capital to. Also to how cycles might evolve differently to how they have in the past.

As ever, Buffett says it best:

"Forecasting interest rates has never been our game, and Charlie and I have no idea what rates will average over the next year, or ten or thirty years. Our perhaps jaundiced view is that the pundits who opine on these subjects reveal, by that very behaviour, far more about themselves than they reveal about the future.

That rosy prediction comes with warning: Anything can happen to stock prices tomorrow. Occasionally, there will be major drops in the market, perhaps a 50% magnitude or even greater.

Equities are much better long-term choice for the individual who does not use borrowed money and who can control his or her emotions. Others? Beware!" Warren Buffett

I hope these reflections were of use.

Kind regards

Andrew

firstname@hollandadvisors.co.uk

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as managers to.

Disclaimer

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by Financial Conduct Authority). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.