朱雀基金
Rosefinch Fund
[021]2030 5888 [021]2030 5999
58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

Rosefinch Research | 2022 Series # 5

Don't Waste the Dips

The early drop in equity markets at start of the year is hardly news: research showed that in the last 20 years, there were 8 years when the market opened with a drop. There was not a clear correlation on the final end of year returns though. There's more divergence when we go into sector or company level. When the market is volatile, the blue chips may be getting ready for a once a decade rally; when blue chips fall, the small and mid-cap stocks may be jumping up; when the market index drops, the market leader may be setting up the double-play to push up both EPS and PE ratio. There's no definite causal relationship between broad market performance vs investment returns. What then is the key factor in superior investment returns for fund investors?

The answer lies in alignment between the investor and the fund manager across three key parameters of time horizon, risk tolerance, and investment philosophy. That sounds simple enough, but hard to do in practice. After all, everyone has that "get rich quick" dream, and you can't educate away the emotions fully. Investment is actually a continuous learning process under volatile conditions. When the fund has a huge year, the investors may become euphoric and overestimate their abilities. Time to take out the DIY kit, open that PA account, and turbo-boost the returns! In this period of irrational exuberance, it's hard to stay level-headed to analyze the position, risk tolerance, and investment strategy. Often, it's only when market has a substantial correction that the investors reflect on the situation. The question investors ask then is: should I buy dip, or cut loss?

Before we answer that question, it's worth looking at a few famous examples. Take Soros: when the stocks he bot go down, he will cut right away because the market is telling him that he is wrong. Buffett, on the other hand, will buy more on the dip. Yet both Buffett and Soros made money using their seemingly opposite strategies. Buffett made his money on value-investing: the lower the entry price, the better the value. So long as the fundamental reasons remain sound, he is happy to buy more on dips. Soros made his money on reflexivity theory: he'd get in the market at start of the trend, ride it, and then cut or even reverse position at the end of the trend. To win like Soros, you'd need extreme sensitivity on the market pulse, a rare gift in the dynamic and complex market these days. As for Buffett, he described his investment philosophy as 85% Benjamin Graham and 15% Phil Fisher. Buffet simplified his investment decision as follows: "I don't look to jump over 7-foot bars: I look around for 1-foot bars that I can step over." **Whether you are a Soros or a Buffett, the key is to know how you intend on making the investment returns, and whether you have the skills to execute the 'how.'**

Investment philosophy takes a long time to evolve and crystalize. Initially, the momentum investors may find it challenging and rely on value investing; or the value investors may find themselves more successful at momentum trading. There's no right or wrong here, just whether there's alignment between the investor and the fund manager. Aside from the obvious investment philosophy, time horizon and risk tolerance are also important. Most investors will agree that if their risk tolerance is low, then directional equity funds are not good investment products for them. Just like it's typically the experienced swimmers that drown, it's the investors with high risk tolerance that lose the most money on equity funds. While investors may claim they can withstand drawdown of -10%, -20% or even -30%, when the losses are staring at their faces, that risk-preference survey is probably the furthest thing from their mind. The emotional rollercoaster will overcome these investors' tolerance levels, as they cut positions to run away from the fear. And when the fund rallies to new heights, their thirst for profits and fear of missing out will drag them in again. This "sell low and buy high" behavior is well written in the annals of investor journey. It is what's preventing some fund investors from profiting on equity fund products. Indeed, recent market research showed that China equity mutual funds outperform China equity mutual fund investors' accounts: in the past 15 years, the active equity mutual fund index returned 16.6%, while the average mutual fund investor account returned 8.9%.

When facing the greed and fear, those fund investors that build high trust relationship with fund managers will find it easier to capture the long-term returns. They are aligned with the fund managers on the investment approach, and trust that no matter market is rallying or falling, the fund managers will do their best to manage the assets. The trusting relationship takes time to build, and needs to have solid foundations like investing in the fund with the appropriate investment philosophy, good reputation, and satisfactory track record. Investors want to find the fund manager with high ethical standard, extensive management experience, and aligned interests. On the other side, it's also important for the fund manager to bring in AUM that's appropriate for their profile, otherwise the mismatch may become a distraction during time of stress.

And we know stressful times will come: every market dip is an opportunity to assess whether there's a good match between the investor and the fund manager. **Each market dip can help both parties to align expectations and build trust.** When the market drop comes, the investor should not ask about whether the fund NAV will return, but whether the fund manager will stay true to the declared investment philosophy? Will the fund manager stay with their proven capability, or will their investment style will drift with the market's flavor of the day? Will the fund manager walk their talk? Only after continued dialogue and communications can the investors and fund managers build such trust and alignment. Once the trust foundation is established, they can then travel the journey together and grow with the investment portfolio towards future success.

We all have huge potentials but are held back by the many distractions. The real tragedy is not about making poor choices, but making the right choices yet couldn't stick with it. The fear of missing out is again rearing its head as we want to jump on whatever is the talk of the town. This constant switching will sap our energy and leave us worse off at the end of the game. **When playing the game of investment, choosing one path also means rejecting the rest. The winners are those who focus on the path ahead rather than the latest score cards.** Learn to withhold our innate desire for that overnight jackpot, face our greed and fear, and seek a deeper understanding of ourselves. Do that, and you will find success in the long-term. Practice that at the next market dip, and see what you notice. Don't waste the dips!