Dimensional

OUTSIDE THE FLAGS

Every Quarter Counts

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An investor following daily financial headlines in the past quarter might have encountered plenty to worry about – from a resurgent pandemic, to spiking inflation, to worries about Chinese debt, and to speculation about central bank tapering of policy stimulus.

In Australia and New Zealand, renewed lockdowns in the face of the more virulent Delta strain of coronavirus dented recovery expectations, led economists to warn of a negative GDP number for the quarter, and forced some companies to lower earnings expectations.

Yet, equity market returns weren't that bad. The Australian market, as measured by the S&P/ASX total return index, rose 1.8% for the quarter and was up nearly 31% for the full 12 months. Developed markets outside Australia rose nearly 4% in AUD terms in the quarter and 28% for the year. The NZ market rose nearly 5% in the quarter and 13% over the year.

Premiums related to small and low relative price stocks were very strong for the past 12 months. In Australia, the S&P Australia BMI Value Index rose more than 40%, while the S&P/ASX Small Ordinaries index was up more than 30% in AUD terms.

For the third quarter on its own, premiums were mixed. In Australia, size and value were positive, but profitability was negative. In other developed markets, size was negative, while value and profitability were mixed. In emerging markets, value and profitability were positive.

It was also hard to see a pattern in sector returns. For instance, energy stocks were very strong in developed markets, while materials were weak – reflecting in part a divergence between sharp increases for coal and natural gas prices, and sharp falls for iron ore prices.

Country returns were also hard to pick quarter to quarter. Having been a laggard in the three months to June, New Zealand turned around to be one of the best developed markets in the September quarter. By contrast, Australia lagged other developed markets this quarter.

There are a number of takeaways for investors from all this. One is that it is tough to chart your investment course according to daily headlines. Markets are forward-looking and news is quickly built into prices. Even if you could predict the news, you still have to guess how markets will react. That's not easy.

A second takeaway is that diversification – across countries, across sectors, across asset classes and within asset classes – is your friend. For instance, New Zealand was the worst performing developed equity market in 2017. Two years later, it was at number one.

Investment opportunities occur across the globe, and it is impossible to know where the best returns will be year to year or quarter to quarter. You are better off holding equities from markets around the world. Some will do better than others quarter to quarter, so, again, stay diversified.

The same lesson applies to the premiums within equities. We know small and value stocks offer higher expected returns than large and growth stocks over the long term. But those premiums are not there every year or every quarter. They appear in different places at different times. The only way of capturing them when they do show up is to stay diversified and focused on them.

We saw that in the September quarter. While emerging markets were down overall, a strategy that focused on *value* stocks in emerging markets posted positive returns.

The final lesson relates to discipline. The past 18 months have been a tumultuous time. We saw major equity markets fall by between 30-40% in the space of a few weeks in March, 2020, only to rebound in the subsequent months to recover all of their losses. The New Zealand and Australian markets both hit record highs in 2021, in January and August respectively.

Now, of course, the media pundits are out in force again, speculating about what will happen when central banks begin to pare back the stimulus, what reopening borders will mean should Covid get out of control again, and what spiking energy prices might mean for inflation.

These are interesting questions, of course, but it's worth reminding yourself that all these opinions and forecasts are already reflected in today's market prices. All that punditry you see in the media is really just yesterday's news. And no-one knows what tomorrow's news will be.

None of this is to deny that the world faces challenges - in overcoming the pandemic, in dealing effectively with climate change, and in building international cooperation. But remember those challenges also hold out the promise of productive solutions that generate long-term wealth.

When you invest for the long-term, you are seeking to be a part of those solutions and to share in the rewards generated by them. Through embracing market prices, employing diversification and exercising discipline, you increase your chances of doing so.

In other words, every quarter counts.