Seed Weekly

31 July 2019

Can Market Timing Work?

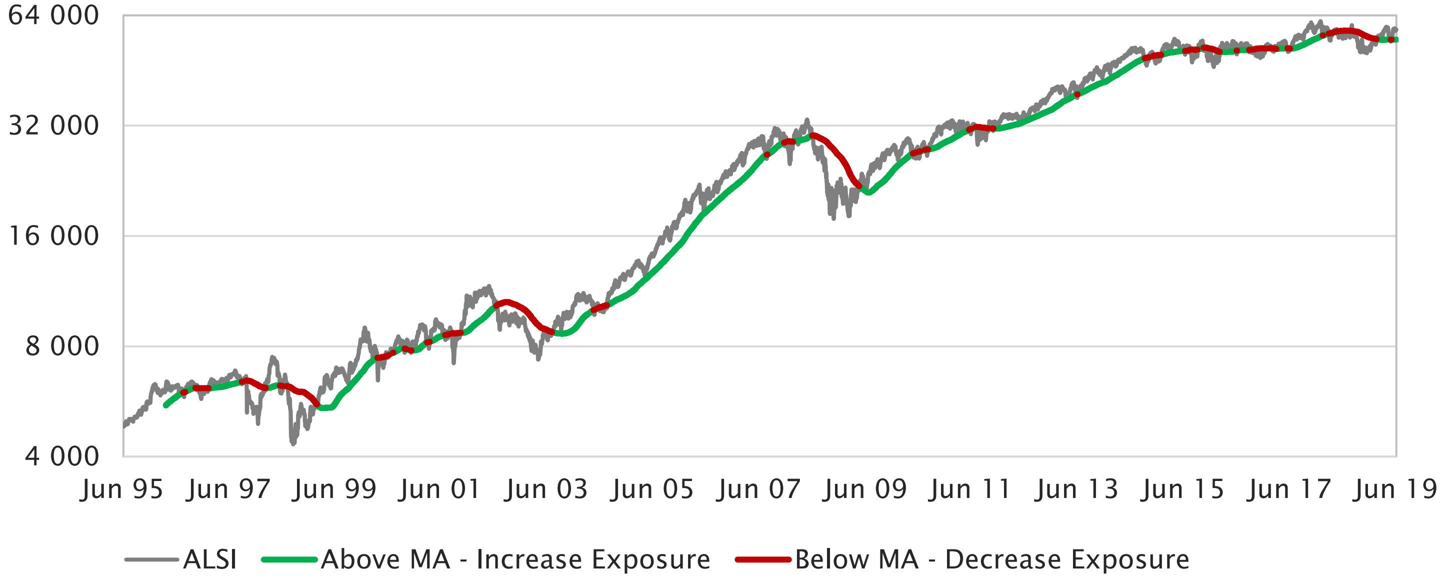
While recently going through some research conducted by one of our global research providers, BCA Research Inc, I found myself wondering if their findings (performed on major developed markets and then on emerging markets in aggregate) had any relevance to South African investors.

The report focused on momentum investing, and how it has existed for hundreds of years and outperformed all other investment styles. Momentum has continued to outperform even as it has become more widely known and documented. As a result of strong behavioural biases driving momentum, BCA hypothesise that momentum will continue to outperform in the future. The below quote was used to illustrate how momentum has been a long-standing phenomenon:

Merchant: In this chaos of opinions, which is the most prudent?
Shareholder: To go in the direction of the waves, and not fight against powerful currents.
- Confusion de Confusiones, Joseph de la Vega, 1688.

Momentum investing can take various forms, but for the purposes of today's report I will look at time series momentum. Essentially this form of analysis looks at current market pricing in relation to past market movements in order to determine whether one invests or remains on the side-lines.

For equity market investing, BCA recommended looking at moving average cross-over strategies, which basically means that investors increase equity exposure when markets are above their moving average levels and decrease equity exposure when markets are below their moving average levels. They recommend using a 200 – 300 day moving average. For the purposes of this report, I used the 200 day moving average on the ALSI. The chart below shows how this strategy would have worked if used over the past 24 years (longest period I could get daily data for). Exposure gets increased when the ALSI moves above the moving average (green) line and decreased when the ALSI moves below the moving average (red) line.



Source : Seed Investments (30 June 2019)

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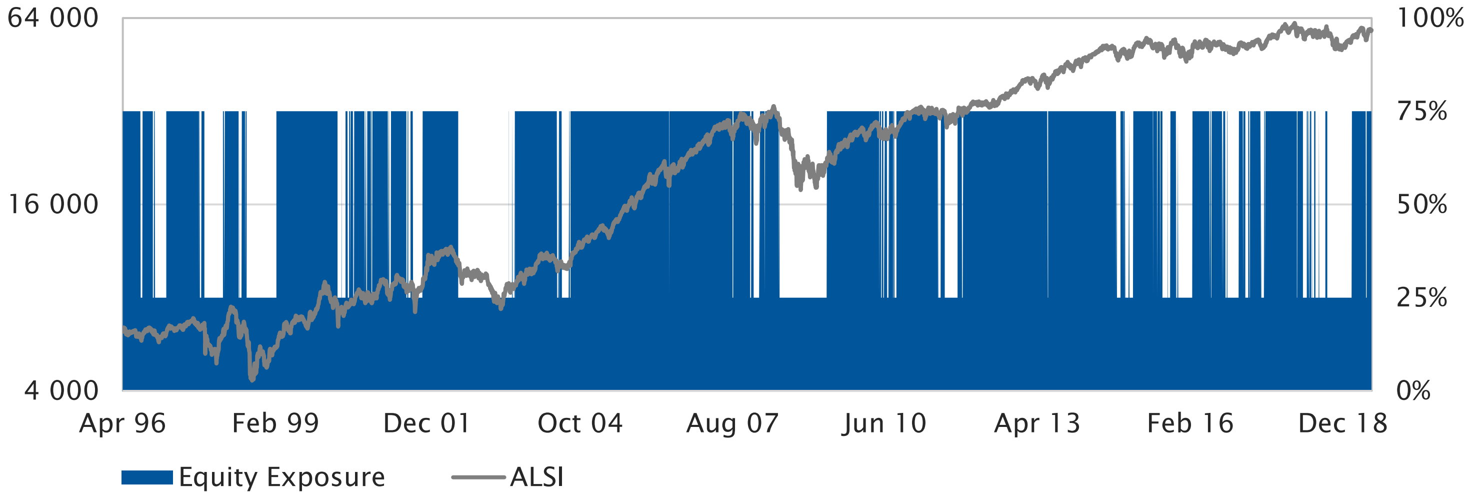
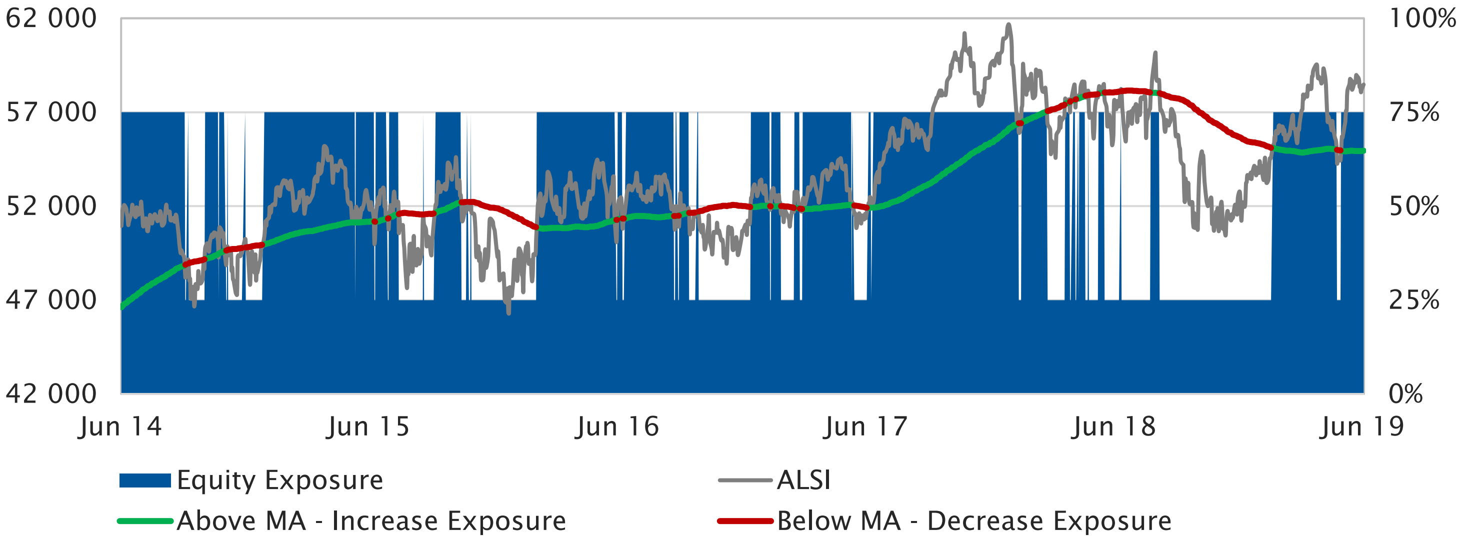
A quick eyeball of the chart shows how investors would typically have been invested in periods of positive markets and have reduced exposure during large market corrections. Naturally, this kind of strategy (like any other strategy) will never work 100% of the time, but the results of using this simple strategy in a predefined process are quite staggering.

The strategy invests 75% into the ALSI when the current level is above, and 25% into the ALSI when the current level is below, the 200 day moving average with the balance parked in cash. The chart below shows how the asset allocation would have changed over this period:



Source : Seed Investments (30 June 2019)

The average equity weighting of this strategy is 61% and over the 23 years, 189 switches from 25% to 75% (and vice versa) would have been made. This is quite a high turnover strategy (particularly in the past 5 years as shown below) and therefore requires a robust process to track the required changes.



Source : Seed Investments (30 June 2019)

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This simple research excludes the obvious impacts of costs and other variabilities but, given the prospects for such a strategy to improve risk adjusted returns, more detailed research is warranted. Over the period measured, this strategy of shifting the equity weight between 25% and 75% generated a return materially in excess of the ALSI with significantly better risk statistics. Based on the above, we will continue our research. In short, it looks like market timing in a proper risk-controlled framework can work!

Take care,

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Portfolio Manager

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ADDITIONAL INFORMATION (where applicable)

Performance has been calculated using net NAV to NAV numbers with income reinvested. Full performance calculations are available from the manager on request.

DEFINITIONS (where applicable)

Annualised Return	Annualised return shows longer term performance rescaled to a 1-year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.
Highest and Lowest Annual Return	The highest and lowest returns, since launch, for any rolling 1-year period have been shown.