Investing In "Inches"

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Vince Lombardi, the former coach of the Green Bay Packers (1959 to 1967), was the winningest coach in professional football history, winning more games in a shorter period of time than any other coach before him. Throughout his career in Green Bay (plus one more year in Washington), he compiled a regular season winning percentage of 0.75, the highest on record *(packers.com/history)*. His teams won about three quarters of the games they played. The NFL even named the Super Bowl trophy after him! One of the most iconic motivational phrases on the subject of football is attributed to Coach Lombardi:

> *"Football is a game of inches and inches make the champion"*

Unsurprisingly, that phrase can be carried over to many aspects of life, and one of those is investing. Investing, like football, is all about the long game. You can fight for every upward inch of gains, but you also need to be equally stingy on preventing large losses. Every inch adds up, both forward and backward, so there are periods where you have to be brilliant on offense as well as periods where you have to be tough as nails on defense. During those very occasional periods where panic is pervasive in the market, that may be the most opportune time to go big into equities (offense). Conversely, when stocks have already been pushed up and pushed up (in anticipation of better future earnings or revenues), at some point we have to assess whether or not those now-elevated prices have gotten way ahead of themselves, as they so often do. The higher the price you pay today for the future cash flows of tomorrow, the lower your expected future returns. That is just basic math, and that math might be suggesting that now is a time more defense is in order.

Planning and plodding are two important ingredients for success over the long haul. Anything can happen in the short run, and it often does. Hot markets, highly speculative episodes, and unforeseen positive announcements can contribute to explosive gains in short order for amateurs and professionals alike (and we've participated in a few of those!!). These are the times that you gain yards, not inches. Performing at a respectable level over a complete market cycle is an entirely different animal. Those occasional (and often explosive) episodes of high speculation often follow the familiar pattern of rising slowly at first, followed by a steepening of the curve until the point is reached where the direction is nearly straight vertical. Those are the most exciting times for the speculator and investor alike, but it can also represent the danger zone. Tops often come due to buyer exhaustion (usually without notice), and then they can rapidly collapse on the other side. We've been witnessing a high number of these vertical episodes in 2023 and into 2024, which may suggest that the danger zone is also a higher probability event today. The greatest amount of trading volume tends to coincide with the highest prices. For every seller there must be a buyer (as stocks often shift from strong hands to weak hands), suggesting the greatest number of participants stay too long and often bear the brunt of the pain that corrections and collapses deliver once a crescendo of speculation has passed.

"It's a game of inches." Strategically you can be on offense or defense. However, moving to defense means taking what the market will give. The most important component of long-term success is staying on the field, maintaining patience, and knowing when to shift from offense to defense. It may seem like forever waiting for those really rare buying opportunities, but I have seen many of those in my career, and I have no doubt I'll see many more. Waiting for those moments when your margin for error is extremely low and your potential for massive profits is quite high is something really special.

The long-term investor who waits for those rare moments (when markets are consumed by complete panic) needs to be properly positioned for that. It won't do any good to be fully invested in risk assets that go down when nearly everything is under attack. One must strategically manage the asset mix to include more liquid (and sometimes boring) positions while potentially under-performing major market indexes (such as the S&P 500 or the NASDAQ) so as to be in a superior position when things really go south. That is hard for a lot of people to do because of FOMO, or the "Fear of Missing Out." Putting yourselves in a defensive position can also seem an unnatural approach to investing, but the purpose for doing so always makes a whole lot more sense once a major market correction hits. Your ability to capture optimal gain potential with low levels of risk will only be facilitated when you can tap into a pool of liquid reserves that you had already set aside. Under market duress for others, you are now able to strike while the iron is hot at a moment when most others are hitting the SELL button and may be in maximum panic mode, or worse, are being forced to sell due to margin calls (or just trying to preserve what little they have left!). Although it cannot be predicted in advance, we do know from history what "toppy" markets look like, the kind that precede major market corrections, and it sure appears to me that many of those markers are present.

Waiting is the hardest part. Waiting mode might mean we sit with safe and liquid securities along with some smaller positions on some attractive (but not particularly exceptional) opportunities here and there just to keep some of your excess earnings working. Strategically, maybe you add some securities that may be under-valued, under-owned, and out-of-favor temporarily as the rest of the crowds are still rabidly chasing those previously mentioned highly speculative issues, all the while mentally preparing yourself for a moment in the future where those speculative bubbles burst with a downward force that wreaks unpredictable collateral damage. In the game of football and in the markets, you can slog along fighting for an inch here and an inch there, patiently preparing for those brief but highly opportunistic moments when you can own the field. It is often easier to say and harder to do, but Coach Lombardi was a master of inches, and we can be too.

So, where are we at this moment in time? There continues to be evidence of high levels of speculative behavior and "hot spots," and so that raises the concern that the price paid today may not square with the expected future cash flows of tomorrow in terms of risk/reward. The areas getting the most attention currently are AI, weight-loss drugs, and nearly anything to do with crypto-currency. This doesn't mean we're going to go off a cliff tomorrow. But, there are enough areas of the markets that place them in the upper stratosphere of historical valuations and, as such, it may make very good business sense to establish a more defensive posture for those who are more protective of their base of capital.

In my opinion, patience will be an important factor for the rest of 2024. Gold, the metal, has broken out to yet another all-time high this year, but you sure wouldn't know it by watching the financial news channels. It seems that all they talk about are the areas mentioned above, but nearly nothing on this subtle but very steady emerging bull market. I believe this will change if the prices of gold, silver, and some other base metals continue to trek higher.

It is the history of the S&P 500 to cycle though leadership sectors, so perhaps we are getting closer to a shift here as well. It may be high time for Information Technology to cool and for Basic Materials to rise. After all, the threat of inflation does not seem to be going away anytime soon, and the materials sector has benefitted from inflation in the past. Information Technology is currently about 27% of the S&P 500 Index, while Basic Materials (which include precious metals, but not exclusively) is currently less than 3%! This lop-sided situation may be ripe for change and, if so, may be very beneficial to our precious metals exposure.

Conclusion:
The opportunity to do "bottom-fishing" and finding great stocks at fire sale prices could be somewhere ahead, but between here and there, we are going to need to continue to decide how we want to gain our advantage on the field. Do we stay on offense and maintain an over-weight positioning in equities, or is it time to get defensive and rotate more and more into low-risk opportunities? The Dow Jones and the S&P 500 Index have hit new all-time highs during the month of March, and they may have more to go. Are you OK with lower participation while these records are being set? I've given you my view above, and so you know where I stand.   Just as Lombardi could motivate his team to win inch by inch, each of us must find that same motivation. Maybe the phrase should change for us:

"*Investing is an endeavor of inches and inches make the champion*"

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Indices are unmanaged and are not available for direct investment.
The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.
The NASDAQ-100 is a modified capitalization-weighted index that is comprised of the largest non-financial companies listed on the National Association of Securities Dealers Automated Quotation System stock market. It includes both foreign and domestic companies, and does not include any financial or investment companies.
The Dow Jones Industrial Average (Dow) is an index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market.