Barmac Asset Management

OUR INVESTMENT PHILOSOPHY

Barmac's View of the Market

Professionals and private investors alike often ask why Barmac Asset Management has an unusual style and approach to investment management………the answer is simple: ***it is dictated by our view of the market.***

Many institutions believe that investments should be held for the long term and that this is the only way to make worthwhile returns. This "buy and hold" strategy may have served investors well when markets have risen for prolonged periods of time (a "bull market"), but we believe this strategy does not hold good when markets are in a prolonged decline (a "bear market").

Where Barmac and most institutions differ, is that we believe we are in a global bear market which has existed since 2000; whereas institutions believe that what we have witnessed is a "bear phase" in a bull market. We also believe bear markets are more common that we are led to believe and often last for more than 10 years.

At Barmac we suspect that most investors believe bear markets are short lived and cyclical. We contend that their views have been distorted by the fact that between 1982 and 2000 the world witnessed one of the most dramatic bull markets in history.

In fact, we think there is evidence to suggest that some investors are in denial that this bull market has ended and what we are experiencing is a bull market correction. There are those who believe that we are now more sophisticated financially than ever before and accordingly, if a bear market does occur, its duration and effects will be minimal in comparison to what has occurred in the past.

In our view, this hypothesis is shown to be incorrect by simply looking at the bear market that has existed in Japan since 1989. This is despite the lessons that have purportedly been learnt by central bankers globally following the bear markets of the twentieth century.

There are a number of factors that have led us to believe that we have been in a bear market since 2000. In 1982, at the start of the bull market, interest rates, gilts and inflation were all in the mid to high teens and P/E ratios were in single figures. It has largely been forgotten that equities at that time were being discounted as the premier investment vehicle. In fact, the reversal of fortunes in these three asset classes provided a "tailwind" and impetus to the 1982-2000 bull market.

The position as far as equity investment could hardly have been worse. By 2000 interest rates, gilts and inflation were all in low single figures and P/E ratios hit the historically high mid-20's. This is a complete reversal of the situation in 1982 and the "tailwind" that benefited the bull market has now all but disappeared.

Our analysis would suggest there are three likely outcomes:-

- Things will carry on as they are (the Goldilocks scenario);
- The world economy will suffer from a prolonged bout of inflation;
- The world economy will suffer from a bout of deflation.

We believe the first scenario is unlikely. It is difficult to say which of the other two scenarios may prevail and it may even be that the world economy suffers from a bout of inflation before suffering from deflation.

Whatever happens, our view is that equity markets will suffer due to the lack of a "tailwind" and the impact of a "headwind" and furthermore, if a rise in inflation occurs as well, then bonds will suffer also.

It is our judgement that the buy and hold strategies that have held good for so long will seen to be irrelevant in this new type of investment environment. No matter how good an institution is at picking stocks, if these are held for a long time, their value will more likely than not to be eroded as market sentiment declines.

Our view is that paradoxically bear markets can be good for equity investors because history shows us that even during these phases markets spend more days advancing than they do declining.

However it is the speed and depth of the declines that make bear market dangerous and therefore if these can be avoided profits can still be made. In fact when the bear market in Japan is considered, there have been years in which the market has made gains of over 50%. This is not untypical of bear markets.

It is based on this view that we have developed our investment strategy and in particular our unique, in-house technical analysis, "The Barmac Indicator".

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