VICTORIA Capital Management, Inc.

Weekly Market Missive

The Market Correction

September 21, 2020

An undeniable characteristic of a bull market in stocks is a periodic decline, consolidation, or retracement of gains made since the beginning of the market advance. Each bull market has different characteristics depending on the economic environment and government fiscal and monetary policies. We have written before about the wide divergence in different stock sectors during this bull market advance because of the impact of the coronavirus and how behavioral patterns have been forced to change. As a result, this bull market has been led by information technology (IT) companies where Covid-19 has accelerated lifestyle changes that otherwise would have taken years to occur. As investors began to recognize this shift, the attraction to these companies accelerated and many of these stocks increased exponentially.

The German proverb “Trees Don't Grow to the Sky,” is often used in financial sectors to describe the dangers of maturing companies with high growth rates. It suggests that there are natural limits to growth and improvement. This proverb may apply today as many of these IT companies are in the early stages of generating growth in revenues and income, yet investors magnify the values of these companies by bidding their stocks ever higher. The best example of this phenomenon is the performance of the NASDAQ 100 index that is up a stellar 26% year-to-date through last Friday. As a result, many short-term investors (or traders) have tried to time the market and are still waiting for a chance to get back in. As professional investors with a combined 86 years of investing in stocks, we know that timing the market never works and being right twice does not have history on its side. Many years ago, we managed a growth equity mutual fund where the fund company allowed market timers to buy into and sell fund shares when their market timing signals told them to do so. When we tracked the record of these timing decisions it was almost always a total bust—and these managers were selling their skills to an unsuspecting public as a viable investment strategy!

When such market corrections are part of an investor’s long-term experience, they become less worried about how a sell-off affects their portfolios. For those investors who are making periodic contributions to their portfolio, such market declines offer opportunities to acquire more shares at lower prices—otherwise known as dollar-cost averaging.

In the near term there are plenty of reasons to justify current market weakness. Obviously, the election as well as the uncertainty of the confirmation of another Supreme Court justice are two. The second wave of the coronavirus in Europe announced this morning is disconcerting as is the absence of a vaccine that could come to the rescue. During this environment of instability, we are focused on the performance of the “survival of the fittest” companies as a good indicator of a resumption in the bull market in stocks. Keep the Faith. Faith is the Spirit!

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