BreedElliott

happiness through sensitive financial planning

Newsletter: February 2023

Strategic Investing v Tactical Investing and Gambling

We thought that this would be a suitable topic for this month’s newsletter as global financial markets have started the New Year a little better than many expected.

At such times, we expect to receive the occasional question from a client along the following lines:

“The FTSE100 Index has shown a healthy increase since the start of 2023. Should I be considering investing more of my portfolio into equities?”

The purpose of this month’s newsletter is to endeavour to provide a generic answer to this type of question by considering the differences between strategic and tactical investing, with a brief mention about gambling.

What is the difference between a strategy and the tactic?

Often, we use the term strategy and tactics interchangeably and in a haphazard manner. Essentially, tactics are the actual means used to gain an objective, while strategy is the overall plan.

Strategy involves planning and, as such, tends to look at a longer time horizon than tactics, which involve physically carrying out the plan and tend to have a shorter-term focus.

The difference between the two concepts can be thought of as follows:

"***strategic** is doing the right things – **tactical** is doing things right."*

Strategic Financial Planning

In this section, we will describe the steps we take when formulating a financial planning strategy with our clients.

Step One is to spend time with our clients encouraging them to think deeply about their plans for the future. There are two key reasons why we do this.

Firstly, in our experience, people lead such busy lives that they often do not take the necessary time out of their busy schedules to really think about their aims and aspirations in the short, medium and long-term.

Secondly, again based on experience over many years of financial planning, when people are encouraged to really think about their future plans, it is uncanny how closely reality matches aims and aspirations. Clearly, if we have a fairly accurate idea of how we think the future will map out, this can be very informative for planning and organising our financial resources.

Step Two involves identifying when future plans and objectives are likely to occur. If we know these with a fair degree of certainty, we can then set a time horizon for any investment. The longer the time horizon for any investment, the more we can expose to higher risk investments in order to achieve higher rewards.

This is because people have time on their side for a recovery in financial markets if they happen to fall.

Step Three focuses on understanding our client's attitude to investment risk. We carry out this stage by having a discussion about the different types of assets available for investment and then completing a questionnaire with each client. We discuss both their willingness to take risks and their ability to withstand risk.

Step Four - Once we have a clear picture of the investment objective, when that objective is likely to occur and our client's risk profile, we can then determine how the recommended investment portfolio will be allocated across the four main asset classes: cash, fixed interest securities, commercial property, and equities.

We will then use this asset allocation as the benchmark for future planning.

Step Five - We will review all investment portfolios at least once per year. At the review, we will check for any changes in the investment objective, likely time horizon and risk profile. If nothing has changed and the asset allocation benchmark remains the same, we will then rebalance the asset allocation within the investment portfolio to bring it back into line with the benchmark.

We believe that following this process is "doing the right things".

Tactical Financial Planning

Tactical asset allocation is a more dynamic investment strategy that actively adjusts a portfolio's asset allocation based upon short term considerations such as timing of an investment into the market. For example, at the present time, a tactical investor may decide to increase the percentage of their portfolio which is invested in equities in order to take advantage of possible short-term rises in equity markets. They may then decide to reduce the equity content once the markets have risen a certain amount.

As a firm, Breed Elliott provides virtually no tactical advice. One area where our advice can be more tactical than strategic is with regard to fund selection. As a result of our research, we may remove a specific fund from our rated shortlist and recommend an alternative fund in the belief that it will perform better than the previous fund in the future. The strategic nature of this decision is that the replacement fund will invariably be in the same sector as the fund from which we are recommending a switch.

The difficulty we have, as a firm, with tactical investing is that there is very little way of knowing whether we are “doing things right”.

Strategic v Tactical

Financial markets are notoriously fickle and we know that it is virtually impossible for an investor to predict what is going to happen.

Although it happened 35 years ago now, it is worth reflecting on the stock market crash in October 1987. Since the beginning of the year, global equity markets had been steadily increasing.

Then, on Monday, October 19, 1987 stock markets around the world crashed, shedding a huge value in a very short time. The day became known as Black Monday.

Interestingly, mutual funds across the globe enjoyed their best inflow of new funds in September 1987 and their worst outflow of funds in November 1987.

Clearly, this is the wrong way round if you are investing tactically.

However, possibly of more interest, is that, although the stock market in the UK fell by over 25% on Black Monday, by the end of the calendar year the FTSE All Share Index was higher than it had been at the beginning of the calendar year!

This tale helps to demonstrate that not only are investors poor at predicting what is going to happen in the future but also that a strategy of buying and holding investments is invariably a sound one as proved over many years by the likes of Warren Buffett.

In a Journal of Finance paper published in April 2000 entitled “Trading is hazardous to your wealth”, the authors, Barber and Odeon, reached the following conclusion:

“Individual investors who hold common stocks directly pay a tremendous performance penalty for active trading. Of 66,465 households with accounts at a large discount broker during 1991 to 1996, those that trade most earn an annual return of 11.4 percent, while the market returns 17.9 percent. Overconfidence can explain high trading levels and the resulting poor performance of individual investors. Our central message is that trading is hazardous to your wealth.”

Conclusion

We believe that the most consistent and, therefore, most likely to be the best way in which we can help our clients to make their money work as hard for them as possible is through following our strategic investment management process.

We believe and the evidence suggests that we are not very good at second-guessing what markets are going to do and so we avoid giving tactical investment advice.

However, this does not mean that you have to do exactly what we say. If you feel that your investment objectives or your risk profile have significantly changed in the light of what is happening in financial markets, then you should let us know immediately.

One way you can reassess your risk profile is by completing our new Attitude to Risk Questionnaire. You can complete this document yourself by requesting a copy from your planner or when we visit to review your investments. We will also save a copy of this onto the Personal Finance Portal for clients who are registered for the Portal. This will ensure that anyone wishing to complete the questionnaire themselves, can do so without necessarily having to contact us directly.

A final word about gambling

Another question we are being asked about more regularly is “Should I be investing in a crypto-currency such as Bitcoin?”

Our question in return is “Are you investing or are you gambling?”

We could spend a lot more time discussing the difference between investing and gambling. The key point is whether there is a chance of losing all of your capital.

There is nothing wrong with having a bit of a punt on Bitcoin, but our suggestion is that you earmark an amount of money aside from your investment portfolio with which you are prepared to make higher risk decisions and possibly lose all of your capital.

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Market data

Market	2022	Current situation	Comments
Interest Rates (BOE base rate)	Increased from 3.0% to 03.50% in December	3.50% at 31/01/23	The official bank rate is 3.50%.
House Prices (Nationwide)	House prices fell by 2.8%	House prices down 0.6% at 31/01/23	Annual house price growth down to 1.1%.
UK Share Prices (FTSE 100)	Closed at 7451.74. An annual rise of 924 points	7771.70 at the close on 31/01/23	The FTSE 100 rose by 319.96 points in January.

Helping you to manage your money

Registered Office
Broadham Manor Woodhurst Lane Oxted Surrey RH8 9HJ