

# THE FORTNIGHTER

October 3, 2014 – Issue #36



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It's been a very good past year in the equity markets and one of the main topics on a lot of investor's minds is the coming stock market correction. That's right – the coming market correction.

The problem is that, while market corrections (declines of between 10% and 20%) are inevitable, no one has any idea when the next one will appear. We're now over 3 years since the last big dip in either the S&P 500 or the TSX index so you would think something's just around the corner.... but nothing yet.

I confess I'm in the "sooner-rather-than-later" camp myself. Valuations on a lot of companies (and to a certain extent, the major indices themselves) have gotten to the higher end of the spectrum. And, in my eyes, a lot of this increase in valuations has been driven by ultra-low interest rates – not improvements in company fundamentals or earnings. And, we "all know" that rates are going to start creeping back up sometime in the not-so-distant future. Given the right catalyst (and there has to be a catalyst), this bull market could be derailed quite quickly.

So, do I recommend doing something dramatic (i.e. moving largely to cash) in anticipation of the coming correction? The answer is no, because that would be market timing and history shows that market timing does not work. If a major catalyst doesn't appear, the world's stock markets could grind higher for some time yet (the markets have pretty much shrugged off some quite significant crises in 2014 – Ukraine/Russia;

Israel/Gaza; Iraq/ISIS). There's little consolation in correctly predicting a 10% pullback if the markets rise 15% while you're sitting in cash....

What I have been finding, though, is that I am raising or holding a bit more cash than I normally would. This is not so much a specific attempt at trying to time the market as it is a natural consequence of the investment and asset allocation strategy I employ.

In an asset allocation model, securities that have risen in price relative to other holdings in the portfolio (typically those with higher-than-average valuations) are sold or reduced to re-balance the model. What I am seeing is that as these more fully-valued securities are sold, the resulting cash isn't necessarily going right back into another stock. That's just something you would expect with a market that is a bit on the expensive side relative to its historic norms – there simply aren't as many bargains out there to re-deploy money to.

At some point, I know that "excess" cash will get re-deployed. The markets naturally ebb and flow and expensive stocks get re-priced until the risk/reward of owning them outweighs the risk-free return of holding cash. That re-balancing event might be triggered by a "correction" and it might not – it's not really that important. It's the investment model that has taken care of the decision, not a crystal ball.



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