# An investor's journey, from FOMO to JOMO

Market minds

Chad Slater

Many readers will by now know of FOMO – the fear of missing out – the social media phenomenon, where, to quote Wikipedia, there is "a pervasive apprehension that others might be having rewarding experiences from which one is absent". Instagram and Facebook have magnified this feeling, as one can now see all their "friends" having a good time without them.

I suffer from FOMO, much to my wife's annoyance, having dragged her out of a perfectly acceptable bar last week to a trendier venue that I wrongly anticipated would be better than the one we were (already) in. Another similarly FOMO-oriented friend would, when driving, proceed to scroll through the whole spectrum of radio stations just in case there was a better song playing than the one he was already enjoying.

Aside from the cheerful anecdotes, there is real downside to FOMO; it has been linked to increased incidences of depression and anxiety, illnesses that are said to be more prevalent among intensive social media users.

So what does this have to do with investing? I would argue that people attracted to the investment profession have FOMO tendencies.

This can manifest itself in a natural inquisitiveness and relentless desire to find ways to do things better. But there is another aspect, and that is obsessively searching for new stocks to add to a portfolio.

Investing in many respects is set-up to feed FOMO: you are continuously reminded about how much better another stock or fund manager is doing; investment bankers are always spruiking the next IPO as a must-own, and if you don't get an allocation, you'll be reminded daily of how much others made from it.

All this leads to a behaviour that legendary investor Charlie Munger calls "leaving your circle of competence". That is buying stocks you don't know as much about (or very little in IPO cases) as a means to feed your FOMO. Munger's point is that you are more likely to fail when you depart from your area of expertise seeking returns in unfamiliar territory.

So far, so depressing. The good news is there is an alternative to FOMO: welcome to JOMO, the joy of missing out.

Some people benefit enormously from thinking hard about living in the present, and weaning themselves off social media.

When we first launched Morphic, we behaved like any other long-only FOMO manager in continuously screening for new ideas. Long-only managers can't go short when they sell a stock, and can't (generally) carry cash, so they are always riding the hamster wheel, seeking new ideas.

But two years ago at a conference in Texas, I happened to overhear two analysts from one of the best fundamental US hedge funds talking about stocks.

The epiphany was that by moving to long-short, you can free yourself from FOMO by recycling the same idea from a successful long position to a pair (where you short another stock against a long), to outright shorting if your view evolves and you now expect a stock to go down. All this without leaving your circle of competence.

How does this relate to self-directed investors? Too often they end up suffering from the same FOMO as fund managers when their stockbroker suggests a new idea, or a friend tells them about a great small cap gold stock that just doubled in price. The evidence is that by performance chasing, they are in fact lowering their returns over the long-term.

While most individuals don't short, they do have a different mandate to most fund managers – cash is a comfortable default option if there are no better ideas. In that sense, they should only add stocks they know very well, and if there are no such candidates, holding cash and not investing neatly fits within Munger's "circle of competence".

So the next time you hear about a great IPO from your friendly stockbroker, think about JOMO rather than FOMO.

*Chad Slater is the joint chief investment officer of Morphic Asset Management.*

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## QSuper rewarded for keeping faith in bonds

the risk that members would lose money, but worried it would increase the risk they would lag behind other funds.

Now it has been vindicated as the fund reported annualised returns of 8.6 per cent over the past 10 years, making it the top rated balanced super fund over that period.

And key to that success was to maintain faith in the insurance quality of bonds.

As interest rates plunged to near zero levels as central banks fought to revive their ailing economies, investors questioned whether bonds, which go up in value when interest rates go down, could protect them as well as they have in the past.

Holzberger, however, rejected this thesis. Just because bond yields were low, did not mean they could not go lower, and it certainly did not mean bonds wouldn't play an invaluable role in protecting a portfolio.

"We were completely confident of the diversifying characteristics, but we need more 'oomph', more substance," he said.

The substance was to load up on "high-duration", or long-term, bonds. High-duration bonds, which only mature in 10 to 30 years, are often considered risky because they are ultra-sensitive to interest rate moves.

By way of example, if an investor buys a 15-year bond that pays a rate of 3 per cent and rising interest rates push that rate up to 5 per cent, the price of the bond will decline by 24 per cent as its 15 years of interest payments are revalued. That of course works in reverse when interest rates fall.

The sensitivity is exactly why QSuper wanted these bonds. When a shock arrived, falling long-term interest rates would lead to strong price gains and negate some of the declines in the value of their riskier equity portfolio.

> It's the strategy of the fund versus the strategy of the asset class.
>
> Brad Holzberger, QSuper CFO

The key to the QSuper team's success was backing the insurance quality of bonds.

"What looks extraordinarily risky to a bond manager in isolation looks to us to be the perfect risk-reducing asset if you have got a gutful of equities. It's the strategy of the fund versus the strategy of the asset class," explains Holzberger.

Holzberger says the strategy, which also involves investing in corporate bonds as a "risk asset", has worked extremely well. The bond portfolio produced returns that have rivalled stocks, despite an enduring bull market.

"It's hard for members to understand that they are paying nothing for very strong risk management."

Holzberger says when it comes to bonds there are many misconceptions. One is that the yield on the bond is the return the investor will ultimately achieve.

"The yield to maturity would only be the return if you bought a bond and held it towards maturity. That's the big Rubicon that you have to cross."

The capital gain potential of low-yielding bonds was demonstrated in 2018. QSuper's holding of high-duration Australian government bonds, which only yielded a modest 3 per cent at the start of the year delivered a return of over 10 per cent, of which about 7 per cent came about because of the increase in price, as long-term global bond yields declined.

These gains are why QSuper was the top-performing super fund in 2018, returning 2.8 per cent

Holzberger says he is not suggesting they have found a "secret sauce". There is nothing secretive about a strategy that is as old as time. Bonds can and do underperform at times.

But he says he had to work had to defend the strategy. "When others have advocated or debated this with me and public forums. they say 'yields are low, bonds are a return-free asset'.

"I say – 'I agree those are your bonds. If we talk about my bonds then we come to a different conclusion'."

QSuper's strategy has also been questioned because some believe it is a version of "risk parity" – in which an investor dials up exposure to safe assets such as bonds so they are taking the same amount of risk compared to more volatile assets such as stocks.

Others point to the high allocation to illiquid assets such as infrastructure, which at 16 per cent is three times higher than the typical balanced fund, although its cash weighting of 12 per cent is more than double the typical allocation.

"They have a different approach. I may not agree with it, but I respect it," said one chief investment officer.

QSuper does not formally engage with asset consultants, but Holzberger says he "can see the filtered outcome of the advice in other portfolios".

The strategy of owning high-duration government bonds against a portfolio of equities has worked well. But, Holzberger explains, it requires keeping a close eye on movements in the bond market.

For keen observers of the Australian bond market, a key moment occurred in February 2018 when 10-year US interest rates exceeded Australian bond rates. That has prompted the fund to build its holdings of high-duration US bonds. If markets wobble, those bonds should gain in value while the Australian dollar may fall further relative to the US dollar.

Holzberger says he's not worried that the strategy won't work as well, because bond rates are low. But he is worried if the "yield curve" becomes flat.

A flat yield curve means short-term interest rates are broadly equivalent to long-term interest rates. That poses a challenge to investors on long-duration bonds because they aren't getting as much compensation for taking interest rate risk and the capital gains from falling interest rates may also be reduced.

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