Global Thematic Diary
Iain Little 18th March, 2021

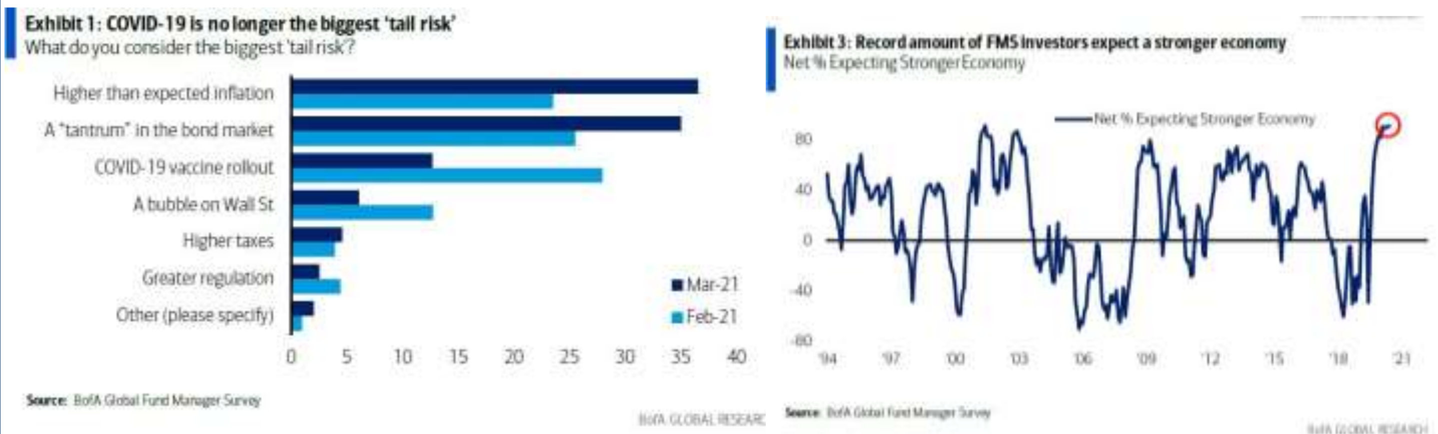
Of Cigars, Contrarians, Nerds and Herds

"Prediction is difficult, particularly when it involves the future". Thus spake Mark Twain, a notably unsuccessful investor, who smoked 10 cigars a day, but successfully predicted the year of his own death.

But prediction can pay off mightily in financial markets.

In a nerdy statistical act about 30 years ago, Bruce Albrecht and I tested for a reliable method of measuring market consensus. Our objective was to discover where institutional bets were placed. We speculated that this approach would work well at market extremes because of the phenomenon of "herding"; if all money bets are facing in one direction (ie the herd is committed to a single outcome), new money available to support that bet tends to exhaust itself; the chances are high, therefore, that it's wrong over time. Since 1991, the year I founded our Contrarians Club in London for hedge fund managers, investment analysts using computers with far larger muscles and brains than the ones we had in 1991 have made an art out of measuring extremes in sentiment and market positioning.

For financial world positioning as a guide to the future, the Bank of America Fund Manager Survey usually wins the fattest cigar. Let's take a look.



Attitudes to risk have changed. In one month, investors have relegated Covid 19 and its mutant strains to the side-lines. They now obsess over inflation and a shaky bond market. Those who feared an equity bubble in February, spurred on by strident warnings from market opinion formers like Jeremy Grantham and Ray Dalio, have diminished in number and are keeping their heads down.

Anyone following 10 year USD bond prices will not be surprised. The move from 0.5% in August to 1.60% in March, a near tripling, has spooked bond buyers, with a consequent hit to gold, highly priced technology shares and other interest rate sensitive assets. But a more subtle and longer term conclusion may be drawn.

If sentiment is indeed registering such a confident attitude to growth and risk, it is reasonable to assume that investment positions are now largely in place to reflect that view. If so, the next concern of the market will be its nemesis: growth below expectations. Those investors who are now positioning investments excessively on the side of recovery, value or laggard stock sectors like banks may need to think twice before abandoning their long held commitment to healthcare, FMCG, e-commerce and technology. We are positioning client portfolios accordingly.

As Mark Twain once said: *"if you find yourself on the side of the majority, it is time to pause and reflect"*.

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