THE GLOBE AND MAIL

INVESTOR CLINIC

How did that ‘sell everything’ strategy work out?

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The Globe and Mail
Published Friday, Apr. 22, 2016 5:05PM EDT
Last updated Friday, Apr. 22, 2016 5:06PM EDT

Three months ago, when financial markets were having one of their occasional mini-meltdowns, Royal Bank of Scotland compared the situation to 2008 and issued some extreme advice: “Sell everything except high-quality bonds.”

As rash and short-sighted as that recommendation was, it made headlines in the financial media – and, sadly, may well have convinced some investors to liquidate their holdings.

RBS wasn’t the only financial institution making dramatic calls at the time. Against a backdrop of plunging commodity prices and slowing growth in China, Morgan Stanley predicted that crude oil could sink as low as $20 (U.S.) a barrel. In Canada, Macquarie Capital Markets projected that the loonie would tumble to 59 cents by the end of 2016 and stay below 65 cents for two years or longer.

I wrote a column at the time advising investors to ignore the gloomy predictions. If anything, market downturns are a good time to buy – not sell – great companies at bargain prices, I said.
I bring up these predictions again because today we’re going to review what actually happened over the past three months. As we’ll see, there are some important lessons here for investors.

First, let’s look at the stock market. Since RBS made its call to get out of equities, the S&P/TSX composite index has surged about 1,400 points, or 12.5 per cent, including dividends. The S&P 500 has gained about 9.4 per cent, also including dividends.

Imagine if you’d dumped all of your stocks as the bank suggested. Not only would you have missed some hefty gains, but you’d be sitting on a pile of cash and wondering what to do with it. Do you get back in now at much higher prices? Wait for another pullback? If you wait, how much should stocks fall before you jump in? What if they keep rising?

Clearly, holding through the turmoil of early 2016 would have been a more profitable – and less stressful – decision.

Now, let’s look at oil. The price of Brent crude, a global benchmark, dropped below $30 a barrel in January and again in February. But the lowest it got was $27.70 – still a long way from Morgan Stanley’s $20 prediction.

In the three months since then, oil has done exactly the opposite of what the bears expected. Spurred by a falling U.S. dollar and cutbacks by oil producers in the United States and other non-OPEC countries, Brent crude has rebounded by more than 60 per cent from its January low and now trades for about $45 a barrel.

The pessimists were just as wrong about the Canadian dollar. In January, the currency briefly dropped below 70 cents. But instead of continuing to fall as some analysts had predicted, the loonie has been climbing steadily for the past three months and has recently hovered around 79 cents.

My goal here isn't to dump on the analysts who made these predictions. They're paid to make calls about financial markets. The more dramatic those calls are, the more publicity their firms receive. Clients and the public expect these forecasts: Nobody wants to read a report headlined, "Our 2016 Forecast: Don't Know."

But the truth is, forecasters don't know. They can come up with theories backed by historical data and analysis but, as the past three months have amply demonstrated, they can still be wrong. And it's no big deal if they are. In the vast investing-entertainment complex of financial websites, TV shows and chat rooms, their predictions generate short-term buzz and are quickly replaced by the next headline-grabbing call.

The financial industry thrives on this sort of excitement and action. But as I've written many times, buying and holding a portfolio of high-quality blue-chip stocks – or low-cost funds – is the surest way to build wealth over the long term. That means holding through good times and bad and resisting the urge to trade.

It's not exciting and it doesn't rely on short-term forecasts. But it works – unlike some other advice we've heard recently.

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