April 2017

What Is the Market?

We are often asked, “What do you think the market is going to do this year”? We typically answer, “We have no idea where the market will be on such and such a date”. However, a trait that sets successful long-term investors apart from the crowd is the belief that over time, the market will trend upward. This has been brought out by the markets continuation of upward trends even after the crash of 1929, the bear market of the early 70’s, micro-crash of 1987, and the bear markets of 2000-2002 and 2007-2009.

Even if markets go up in the long-term, they often go down for the short-term. In the instances referenced above, we are always talking about the Stand & Poor’s 500 Index. As we all know, each stock in the index doesn’t go up by the same percentage every day, or every month, or every year.

So what are some other ways that we can look at the market? How can we “slice and dice” it to see what has been working and what hasn’t? One of the most common demarcations is to distinguish between growth and value stocks. Typically, a growth stock is one that has not reached maturity of its product or industry yet, and has to continually re-invest its earnings to continue growing. That usually means it doesn’t pay dividends, or re-purchase stock (both of which tend to improve a stock’s performance over time).

Conversely, value stocks typically do pay a dividend, and some do re-purchase stock when there is a lack of opportunity to re-invest in its existing business. Keep in mind, however, that there is not a formula for growth versus value, there are simply general guidelines. As with any human endeavor, we are always trying to categorize items we compare in order to generate patterns which we can exploit in the future. However, as we all know, investors tend to “see” patterns more often than they actually exist. We think we see a pattern, when really we see certain data aligning to fit a preconceived idea.

You get the point; all of that to describe the first quarter of 2017 in “the market”. On the next page, the chart displays the vast disparity between growth (black line), and value (gold line) stocks. There’s an even greater disparity if you sliced the value stocks even more and simply looked at energy stocks (blue line).

As you can see, the iShares Core S&P Growth ETF (IUSG) was up about 7% for the quarter, while the iShares S&P Value ETF (IUSV) was up only about 2%, and woe to the investor who owned energy, represented here by the iShares U.S. Energy ETF (IYE) which was down roughly 8%.

Shouldn't we just all invest in growth stocks? Why even have value stocks, or worse yet energy stocks, in our portfolio? The answer to those questions is that no single area of the market works forever.

Here is the same chart for the 2016 calendar year.

Energy was up almost 25%, Value was up over 15% and Growth was up just over 5%. As the market goes up and down over time, different areas are leaders and laggards, and unfortunately there are no patterns to discern from it. That is why we always try to find the ways to exploit the difference between the value of a company and the price of its stock. Eventually, after the ups and downs and possibly underperformance, the price and value converge, and portfolios made up of "great" companies do very well.

At Paragon we are looking forward to a busy and challenging year. As we have mentioned before, we are undertaking an upgrade to our technology and service offerings in order to better serve our clients. As of this writing, we are almost complete with the first step of the transition by converting a copy of our data files (since the inception of Paragon in 1998) to the new system. Currently, we are running our existing system in parallel with our new system to compare the processes, the work involved and the output of reports you will see, and reports that we use internally.

Thus far, the transition is going as planned, and you should be seeing new and improved reports sometime during the second half of 2017. Thank you for your continued support as we strive to improve the service we provide.

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