FCI ADVISORS

PERSPECTIVES

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Know the Game

By Jeff Otto, CFA

“The Infinite Game” by Simon Sinek was published in 2019 and inspired by James Carse’s 1986 book on game theory titled “Finite and Infinite Games.” Sinek explores how businesses and leaders achieve long-lasting success through playing with an infinite mindset, as opposed to myopically focusing on short-term wins or finite games.

Football and basketball are finite games played to win. We know the players and coaches, rules are generally fixed and there is a finish line. Finite-minded players crave predictability and fear disruption or events that are out of their control. On the other hand, infinite games have no defined ending. The rules can sometimes change abruptly and there are no winners and losers – only those ahead or behind at any given point.

At FCI, we believe successful long-term investing and financial planning requires adopting infinite mindset principles. A key attribute of an infinite-minded player is they expect surprises and are willing to embrace changing conditions in order to increase their odds of success. Sometimes the disruption is slow moving, such as the impact of technology on various sectors of the economy. Other times the disruption may occur abruptly, such as the onset of COVID-19.

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Lengthen the Investment Time Horizon

According to author Ben Carlson, the average holding period for an individual stock in the U.S. is now just 10 months; back in the 1970s it was five years. In theory, a stock price is based upon the present value of its future cash flows. This calculation normally requires forecasting up to 10 years of future cash flows and also making an assumption about the company’s growth rate into perpetuity. It is very rare that immediate information is presented about a company to change assumptions 10 years out and beyond, thereby meaningfully changing the present value of a stock price. Yet today’s market is overwhelmingly filled with traders moving in and out of stocks while ignoring a company’s long-term potential growth. They are playing an infinite game with a finite mindset.

The emergence of frictionless trading platforms, such as Robinhood, and the explosion of investment vehicles have likely contributed to this trend of shorter holding periods. A recent phenomenon causing extreme gyrations in stocks is the surge in trading of zero-day-to-expiration options – literally an investment vehicle designed to mature in 24 hours. This type of instrument is more representative of a casino game than the practice of long-term, fundamental investing. The impact of this can be felt in very large, sudden movements in equity prices for seemingly no reason.

As long-term investors, knowing what game is being played is critical when faced with this kind of extreme volatility. An infinite-minded investor with a well-constructed, long-term financial forecast for a stock can either choose to ignore this short-term noise or act to take advantage of these market dislocations. We seek to capitalize on these opportunities through adding to or reducing weightings in individual holdings in our various equity strategies as well as through portfolio rebalancing.

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Stay in the Game

The main objective of the infinite game is to keep playing. However, most investors fall victim to the game of market timing despite data showing time in the market is vastly more important. Bear markets, as we experienced in 2022, unfortunately occur every so often and can be quite painful. We do not enjoy, or relish, advising clients to focus on long-term results when an immediate reduction in wealth is front and center, but it is the right thing to do. Our advice is rooted in historical data which suggests making emotional decisions after experiencing a loss can further harm long-term wealth creation. On average, the best performance days in the stock market occur during, or soon after, a bear market. Since 1995, the S&P 500 has a compound annual growth rate of 7.9% per year excluding dividends, but missing just the 10 best days lowers the annual return by 3.0%. That does not seem like much difference, but when compounded through the end of 2022 the fully invested portfolio is worth 122% more than the market timing portfolio.

Diversify to Endure

Portfolio diversification also plays a key role in staying in the market as this typically shields investors from the full brunt of the decline in bear markets. As described in our recent Capital Market Commentary, Silicon Valley Bank (SIVB) abruptly failed as customers made a run on the bank when they lost faith in the bank's ability to repay deposits. While this could theoretically happen to any bank, it is not a coincidence that SIVB's client base was heavily concentrated within venture capital technology start-ups with large uninsured deposits (88% of deposits were above the FDIC limit). This concentration helped propel the stock during a bull market, but ultimately led to its demise when the tide rolled out.

Our asset allocation framework is designed to smooth the extremes of markets through diversification across various asset classes. Any given year a specific stock or sub-asset class, such as commodities, will outperform our diversified portfolio. Finite-minded investors with short time horizons will react to recent performance and chase returns. Heavily concentrated portfolios are more susceptible to negative surprises from which the portfolios cannot recover, much like SIVB. Our asset allocation, security selection and financial planning processes never waver from this infinite mindset; our ongoing goal is to ensure the durability of client portfolios.

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This publication is intended for use by clients of FCI Advisors and investment professionals.

CURRENT DISCLOSURES

Factual materials obtained from sources believed to be reliable but cannot be guaranteed. Past performance is not indicative of future results. Investing in the securities markets involves the potential risk of loss. These investment risks are described in our disclosure brochure (ADV), which can be found on our website: www.fciadvisors.com. Specific securities may be referenced in order to demonstrate a point; these are not investment recommendations. For further information please contact FCI at 800-615-2536 or SourceNotes@fciadvisors.com.

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