WEBB ASSET MANAGEMENT

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Monthly Commentary

SYSTEMATIC, PROVEN & RELIABLE

Commentary

When the World is Upside Down

The behavior of the equity markets, like so many other things today, makes little sense. Many stocks that should be rising are falling and many stocks that should be falling are rising. Quantitative investment models that have had great predictability are failing. Does this fore bode a change?

Let's use the quantitative data from Computerized Portfolio Management Systems (CPMS) to examine the disconnect. Since 12/31/85 the TSX has returned 8.6% CAGR. Over that same period, CP
MS's momentum model produced the highest returns at 21.3% CAGR. CPMS's dangerous model produced the worst returns of -8% CAGR. These significantly divergent returns vs. both the index and each other illustrate the power and predictability of these models.

However, over the last 12 months this predictability has vanished. For the trailing 12 months, the TSX returned 16.7%. Amazingly, over this period the dangerous model was the best performing model returning +26.9%. While the momentum model was the worst performing model returning +13.7%.

Do these models no longer work? The simple answer is no. Models never work all the time. They are effective because they work most of the time and have much higher predictability than just about anything else.

Remember that the significant divergence over the last 12 months of both the momentum and dangerous models are included in the 25 year returns. Given that recent performance has a disproportionate impact on longer term returns, this further illustrates how well these models have worked over time.

Why has the predictability of these models failed over the last 12 months? Simplistically, the market participants moved faster than the analysts' revisions and/or the company fundamentals. Given the extreme V recovery this is not surprising.

One thing that is predictable in analyzing 25 years of data is that when a model's returns deviate substantially from either the index or another model's returns, the probability that that model's returns will mean revert is very high.

Thus, I would expect to see significant positive returns for momentum stocks relative to both the index and the other investment models. This will be to the benefit of our Enhanced Growth Fund.

– Derek Webb

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