Myth Busters

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In this article, I explore the phenomenon of overvalued assets and how social media amplifies speculative investment trends. Drawing from historical events like the tulip mania and the dotcom bubble, I illustrate how investors are often lured into these frenzies by influential voices, only to face future losses. Ultimately, one is reminded to focus on long-term, sustainable investments rather than market fads.

Do investors make money following talking heads?

A litany of bubbles have burst over the years in markets, these include:

- Tulip mania of 1637.
- South Sea bubble of 1720.
- South African construction stocks before the Soccer World Cup in 2010. In 1999, Murray and Roberts' share price was R2.30, reaching R105 in 2008 and 60c in 2023, the same price it was at in 1976!
- The dotcom – March 2000.
- Sub-prime and the Great Financial Crisis of 2007 where US house prices took 10 years to recover.
- JSE listed property stocks - that collapsed in 2018, reaching 2010 levels before staging a recovery.
- In 2017, the price of Rhodium was $625 oz, by April 2021 it reached $30 000 oz. Fast forward to July 2023, the price hit $4000 oz, not far off where it is today.

Investor outcomes – the bubble bulls versus the bubble bears

In these episodes, big voices proclaimed 'this time is different' causing believers to outnumber disbelievers. Doubters were disarmed by escalating share prices and accompanying narratives.

But, after every one of these modern asset deflations, winners emerge and we must ask, "how did they do it?"

What winners do well, losers do badly?

There are two key features that winners get right. They avoid the bubble through skill, cynicism, research, or experience but endure lengthy periods of underperformance as bubbles take long to inflate but are quick to deflate. And they doubled down on their anti-bubble bet by buying the companies, sectors and asset classes being sold down to fund the hype.

Take the dot-com rage that began in 1995 just after commodity company share prices had peaked. Prior to 1995, Anglo American shares had rallied by 76%, this started in October 1992, and ended in September 1994.

But from September 1994 to April 2000, Anglo American shares did nothing but deliver extreme volatility for their owners. Simultaneously, the Nasdaq rallied 500%.

The tech bubble then eventually burst in March 2000, the Nasdaq fell 75% over the following two years, retreating to 1996 levels. Had long-suffering Anglo shareholders simply held onto their shares from September 1994 to the next big correction which was the Great Financial Crisis (GFC) in November 2007, their returns would have been 800%.

For the same period (September 1994 to November 2007), Nasdaq investors made only 267%, and faced a crisis of confidence, with their capital collapsing by 75% over 24-months.

Not all bubbles are hacks

But not all bubbles are obvious hacks (like tulips were or the South Sea Bubble of 1720 or maybe Bitcoin is today – time will tell), in fact, many initiate their lives as legitimate exciting investments with superior growth prospects.

Take cloud computing and AI, these are long-term growth themes and company share prices should reflect this potential. So too were the early price increases in platinum group metals in 2018, reflecting the introduction of Regulation (EU) 2019/631, European emission standards resulting in higher metal loadings.

It is never enough

But, unfortunately, at some point the pole is set too high, disappointment follows and prices fall. The reset is often sparked by one of two triggers.

The first is that an asset does not deliver its expected growth and becomes an ''oh wow'' moment for the market.

The second is that a point of clarity increases the number of doubters relative to the believers. An example being an analyst report informing investors that to justify the share price of a specific listed electric vehicle manufacturer, the expected annual growth embedded in the share price would require that company to sell one of its cars to every one of the 8.0 billion people on the planet.

And then the great unwind begins!

Be a winner, avoid being a loser

So how do you build your capital, avoid fads, and unearth winners like Anglos of 1995?

Start by analyzing the postmortems of past bubbles to find common features, which include:

- Be cautious of abnormal "returns". These are returning well above equities, the best performing long-term growth asset.
- Lack of cash flow – except for gold, which benefits from two thousand years of history, investments are only worth their cash flow.
- The pain trade by dissenters. Allan Gray almost shut its doors in the late 1990’s as it bet on commodities rather than tech, this put them on the map! Charlie Munger avoided hyped real estate.
- Talking heads – fad evangelists accompany big bubbles.
- If it is too good to be true – it is!

And find which areas of the market are out of fashion?

Based on our bottom-up stock research, at Northstar, we believe that the following areas in markets currently offer long-term opportunities:

- Healthcare stocks.
- Consumer staples – populated by some of the world’s most resilient companies.
- Tech stocks that do not need AI to justify their share prices.
- Certain financials.
- Mid and smaller capitalization companies in the US.
- Oil stocks.
- Emerging markets.

Conclusion

Investing success is not a gift of foresight, but rather an awareness of history.

Super expensive investments carry the burden of expectations, this encumbrance is usually too tough to bear. In contrast, ignored, even maligned assets are often, laden with the highest prospective yield.