TURNER INVESTMENTS COMMENTARY

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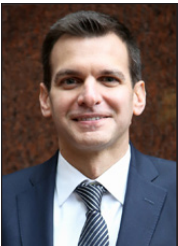

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BUBBLE BATHS

BUBBLES: A MARKET CONSTANT

Do you have a friend or relative who collected Beanie Babies? Remember those cute, cuddly, bean-bag-like children's toys that skyrocketed in value during the 1990s? Beanie Babies became so excessively overvalued that collectors ended up storing them in sealed plastic boxes—never to be, God forbid, actually played with by children. According to Zac Bissonnette, author of the recently published *The Great Beanie Baby Bubble: Mass Delusion and the Dark Side of Cute*, at their peak, Beanie Babies constituted 10% of all EBay sales and turned their founder, Ty Warner, into a billionaire. It was, of course, too good to last and in the late 1990s the market collapsed and the average Beanie Baby is now virtually worthless.

1999 BEANIE-BABY MARKET PEAK: DIVORCING COUPLE FORCED TO DIVIDE THEIR COLLECTION IN A LAS VEGAS COURTROOM

Beanie Babies are just one example in an endless history of bubble markets. Investors have throughout time rapidly attached incredible worth to things that ultimately cannot support this valuation either because of an absence of actual utility (e.g., a Beanie Baby), actual scarcity (e.g., oil) or actual earnings power

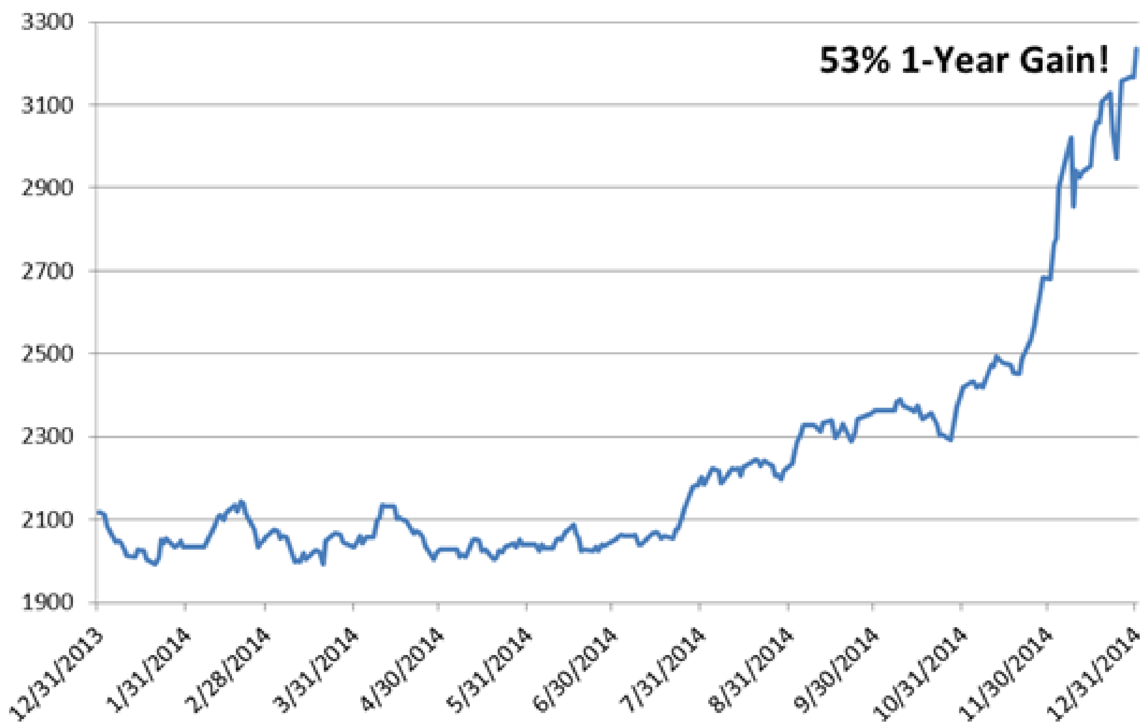
(e.g., a speculative stock). One of the most frequently referenced bubbles is the Dutch tulip mania of the 1600s. At its peak, you could have exchanged, according to Wikipedia, "four fat oxen, eight fat swine, two tons of beer and a silver drinking cup", amongst other items, for a single tulip bulb. More recent examples include, dated from their peak, the 2000 dot-com bubble, the 2008 US housing market bubble, the 2008 oil bubble, the 2014 Bitcoin bubble and, very recently, the 2015 Chinese equity market bubble. The point is that bubbles have always existed, always will exist and must be accepted as a constant aspect of capital market investing.

So the question then becomes: what's an investor to do about them? In our view: absolutely nothing. We believe that the only way to benefit from a rising bubble market and, subsequently, the only way to reasonably protect against the inevitable crash, or 'pop', is to simply have a globally diversified and balanced portfolio.

BUBBLES PLAY TRICKS

Think back to 2014 when China was rapidly trying to establish a more open capital market system, allowing increased foreign ownership of Chinese companies and also encouraging ordinary Chinese investors to direct their savings towards the Chinese stock market, which they did in earnest and in an almost totally unregulated way. The Shanghai Stock Exchange Composite Index soared an incredible 53% in 2014. Almost 18x the percentage gain of global equities overall that year! Chinese equity valuations became stretched and it was obvious that the new market openness was encouraging rampant speculation. Clearly, the Chinese market was becoming overheated:

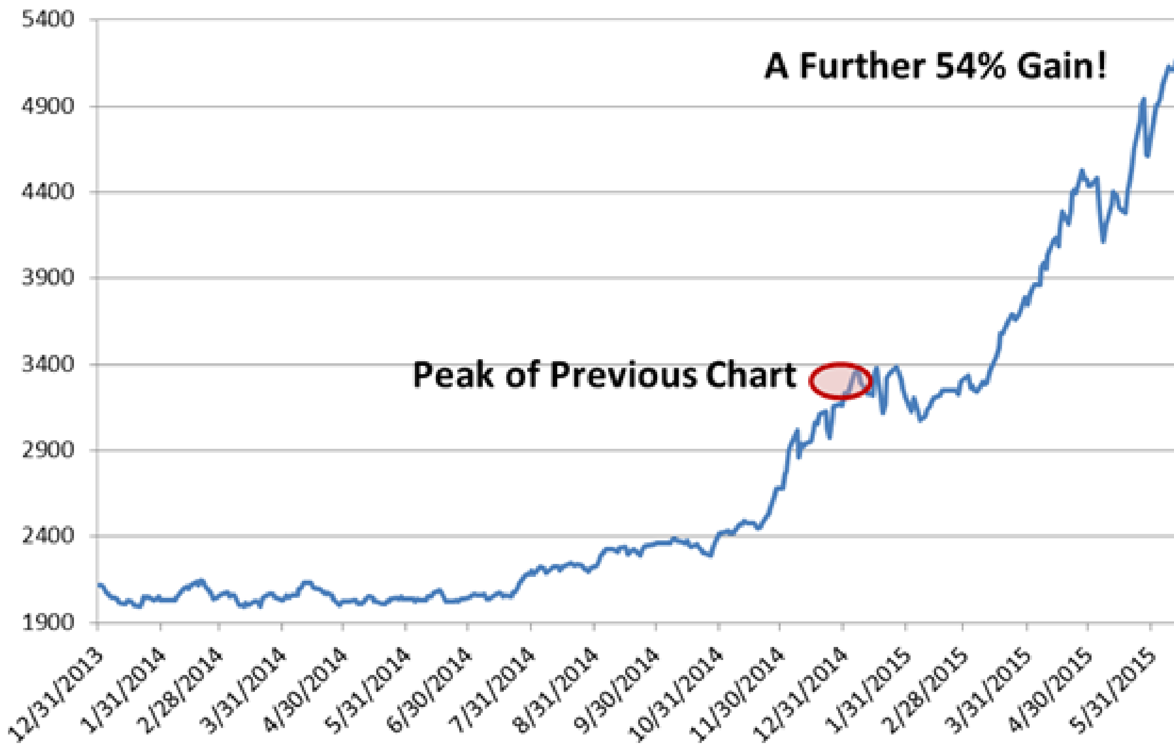
SHANGHAI COMPOSITE INDEX: THE BUBBLE PEAK—2014?



Source: Bloomberg, Raymond James Ltd.

The problem, however, was that the market wasn't even close to reaching its peak by the end of 2014. In fact, despite that precarious looking chart above, the Shanghai Composite actually gained another 54% before reaching its ultimate high-water mark in June 2015:

SHANGHAI COMPOSITE INDEX: THE *REAL* BUBBLE PEAK—2015

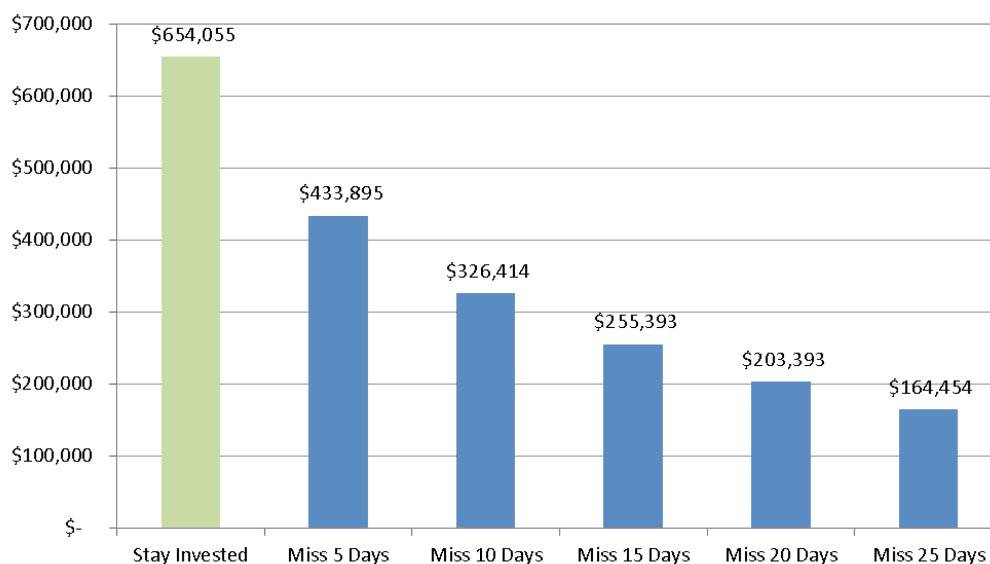


Source: Bloomberg, Raymond James Ltd.

The point here is that investors fail constantly to anticipate the top of any rapidly accelerating market. This is because markets almost always overshoot their historical valuation ranges and momentum becomes a very difficult factor to build into forecasts.

To assume you're gifted enough to repeatedly and accurately time a bubble's peak is fallacious and dangerous. You're just as likely to sell too early and miss considerable upside or buy too late and suffer the declines. Just look at the simple shape of a bubble graph: investors on the left side benefit on the way up, but an equal number on the right side get burned on the way down. The perils of market timing are summed up succinctly in the chart below. You don't need to miss many strong market days to cripple your overall performance. And trying to 'play' an inflating or deflating bubble market constitutes the most dangerous kind of market timing of all. Every mistake you make—selling too early, buying too late—gets amplified during bubbles.

INVESTMENT OF US$100,000 IN THE S&P 500 INDEX (1995-2014): MARKET TIMING IS POINTLESS



Source: Blackrock. Days missed refers to top-performing days.

NEUTRALIZE BUBBLE RISK THROUGH BALANCE AND DIVERSIFICATION

It's certainly not as exciting as riding a lone, roller coaster bubble-market, but your long-term risk management is far better served by having a balanced and diversified portfolio that allows participation in many markets continuously. We can't always anticipate how or when bubbles will develop (who would have guessed Beanie Babies?!) and we certainly can't forecast a bubble's peak; however, we can create for you a diversified portfolio that will give exposure to many markets simultaneously therefore allowing you to benefit from their *combined* long-term ascent and also help protect your money when a *single* market is in dramatic decline. We'll never be concerned by bubbles because any individual market that is evolving in such a way will only ever be a small part of your portfolio and it will likely be entirely offset by another asset class or market that is trending in the opposite direction.

SAMPLE MODEL PORTFOLIO ETFS: LOW-TO-NEGATIVE CORRELATIONS HIGHLIGHTED

ETF Symbol	SPY	XIN	XSB	XRE	XSP	XDV	CPD
SPY	1.00						
XIN	0.51	1.00					
XSB	-0.30	-0.84	1.00				
XRE	0.72	0.45	-0.29	1.00			
XSP	0.99	0.63	-0.43	0.72	1.00		
XDV	0.85	0.62	-0.43	0.85	0.87	1.00	
CPD	-0.26	0.19	-0.19	0.27	-0.22	0.21	1.00

Source: Bloomberg. Raymond James Ltd. Monthly correlations. 10 years data.

Take for example the correlation matrix (above) for a few of the ETFs that you likely own within your portfolio currently. A negative correlation indicates some level of inverse relationship between the two securities in terms of price movement. Such negative correlations are desirable and are an effective way to control risk. Note the high number of negative relationships within the matrix. Having negatively correlated securities significantly limits the downside risk if one particular security gets overheated, or 'bubbly'. The matrix indicates the balance and diversification that the combined ETFs offer—and nothing helps obviate bubble risk better than a balanced and well-diversified portfolio. We know that this strategy won't provide rollercoaster thrills, but it'll be more comforting to you over the long term than even the cutest Beanie Baby.

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