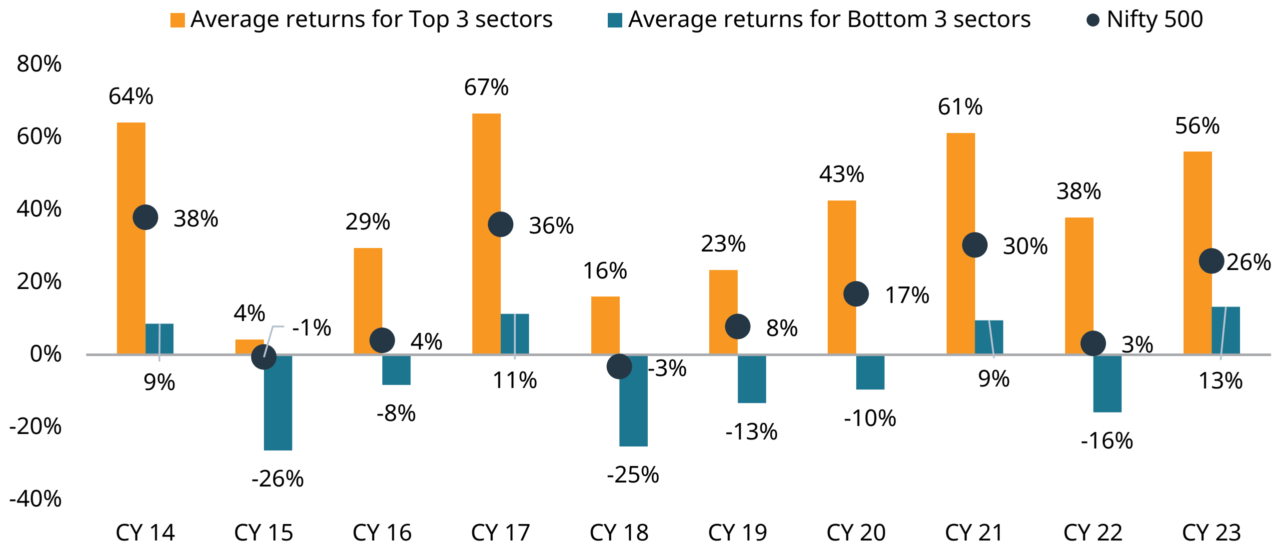
Think of Long term as a series of short terms

Dispersion of returns

Uncertainty is a defining characteristic of equity markets. However, there is one thing about markets that is almost certain: the dispersion of stock and sector returns. No matter what the overall market trend is (up, down, or sideways), there are always relative winners and losers.

High Variance in Top 3 And Bottom 3 Sectors Compared to The Broader Market



Source: MFI Explorer, Union MF Research. NSE Sectoral Indices have been considered.
Period: 31-12-2013 to 31-12-2023. Past performance may or may not be sustained in the future. The above chart is given only for illustration purposes to explain how different sectors perform differently as compared to the overall market. The above data should not be considered as any indication of future returns.

What causes this dispersion in performance?

Dispersion of returns is the result of different sectors and stocks being in different phases of their own cycles at any given point in time. Let's look at this in some detail.

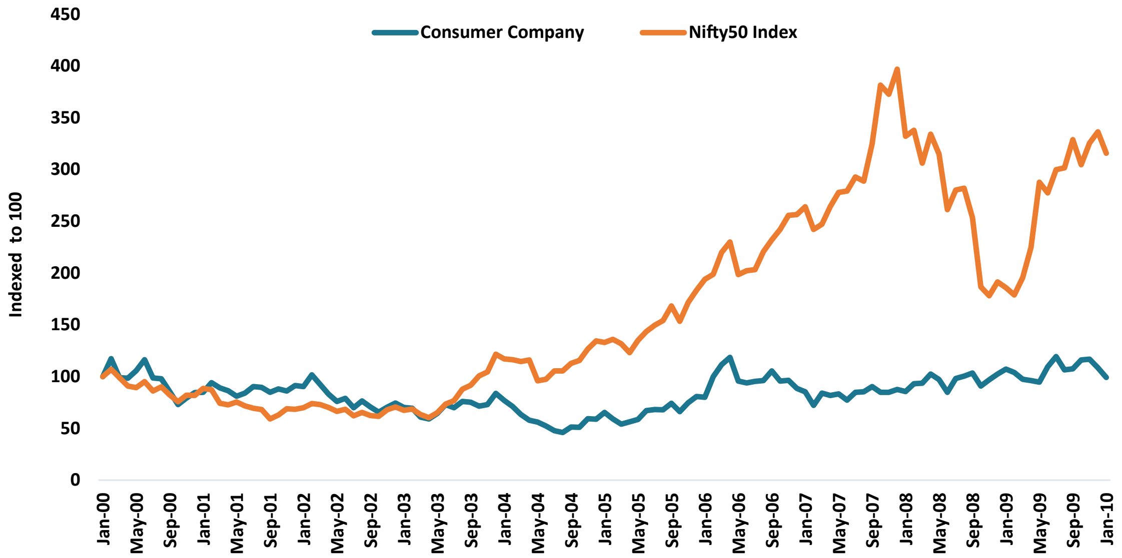
Everything that matters in investing unfolds in phases or exhibits cyclicality- with varying degrees of frequency and amplitude. Consider the following:

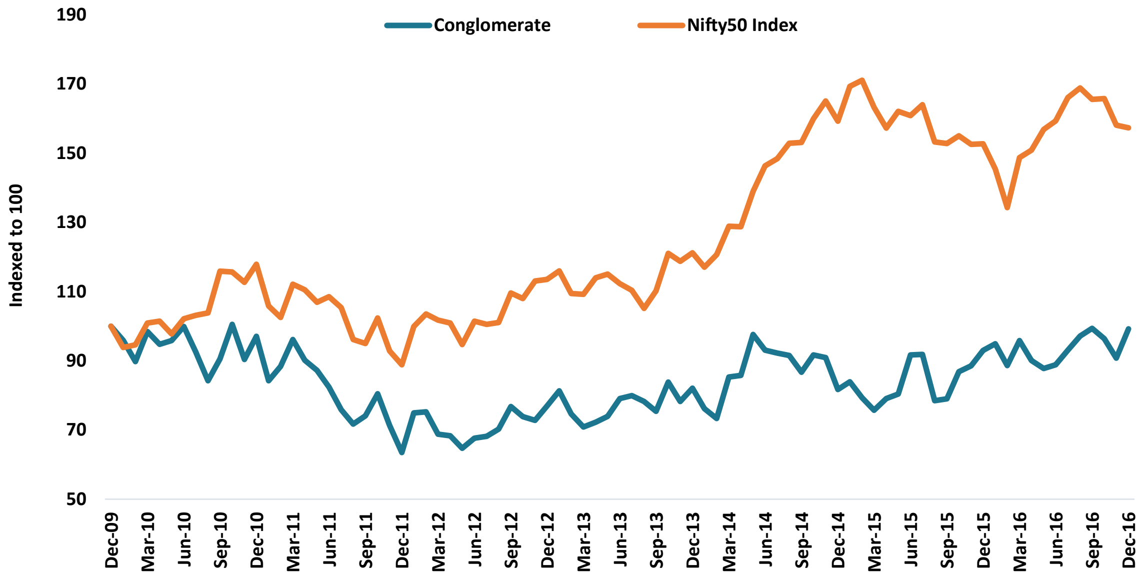
a) Macroeconomic variables such as economic growth, inflation, and interest rates fluctuate.
b) Domestic politics and geopolitical context change with the passage of time.
c) Business confidence ebbs and flows
d) Competitive intensity in individual industries rises and falls based on changes in the profitability cycle.
e) Individual company fortunes alter linked to changes in management and promoter circumstances.
f) Investor sentiment swings wildly from depths of panic to heights of euphoria causing flow cycles.

Generally, these cycles are caused by endogenous factors with the pendulum swinging to one extreme and then correcting due to opposing forces only to swing back to the other extreme and so on. Many times, exogenous triggers also play an important part in the shaping of these cycles. Moreover, many of these individual cycles interact with each other in complex ways. All this heavily influences the trajectories of fair values and market prices resulting in a large dispersion of returns in individual stocks and sectors offering opportunities for investors.

How to play it?

'Buy and Hold' is often recommended as an ideal approach for equity investors. While equity as an asset class is certainly suitable for long-term investment, as discussed before, it is not necessarily true for individual stocks and sectors. There are many examples of stocks of even Nifty companies delivering almost no returns for several years in a row and underperforming broader markets. (Please see illustrative charts below)





So, a good quality of business or management might not offer a guarantee of continued outperformance. Whether a stock or a sector generates outperformance or not is a function of where it is in the cycle and other initial conditions like valuations.

For professional money managers looking to generate consistent performance, it is crucial to embrace the cyclical nature of markets and treat the long term as a series of shorter terms. Adjusting portfolio positioning in accordance with 'where we are in the cycle' helps reduce opportunity costs and optimize returns.

Note: The data given in the graphs above is only for illustration purposes and does not relate to any actual company. Any similarity to actual companies is purely coincidental.