Forget Value. Forget Growth. Here's the real key to investing

Taken from an article in "The Rude Awakening" newsletter November 2, 2015

Here's a tragic statistic:
Texting while driving has caused teenage car accident deaths to *double* over the past decade. I bet you're not surprised. We've all seen the commercials warning against it. Texting while driving is an epidemic that's killing our kids. Except there's one problem - **I fabricated this statistic**. If we actually bothered to look it up, we would know that the number of teen drivers dying in car crashes dropped more than half over the past 10 years. Safer cars and more restrictive licenses have contributed to the trend, according to a recent report from Reuters.

Yes, distracted driving is a problem for younger drivers. But the idea that texting is causing the car accident death toll to rise dramatically is a false narrative. And it's so easy to believe because it fits right into how most of us see the world. *Who hasn't been cut off by some crazy teenager messing with his phone?*

So what are some of the lies we tell ourselves about the markets? Are we really looking at data objectively? Or are we twisting every piece of information we absorb through our own personal narrative filter?

Here's one of those assumptions I've come across more and more lately: ***"You can't beat the market by chasing momentum."***

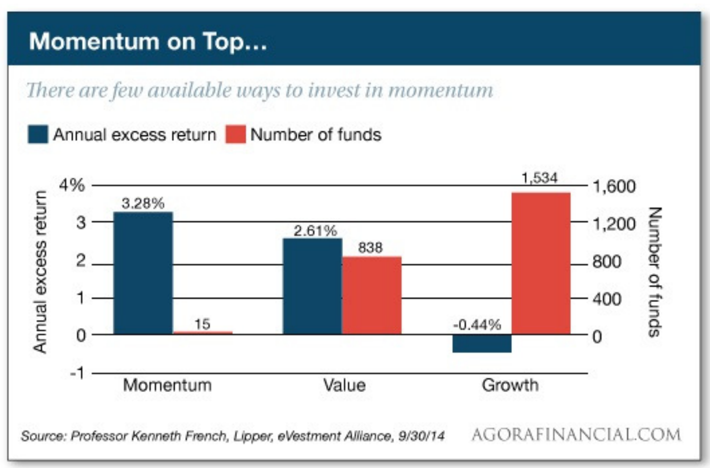
Fair enough. If you put on a suit and tie and read this statement in front of a group of random investors, I'd bet none would argue with you. But this statement is false. Utterly. Let's break it down:

First off, I love how momentum strategies are often discredited simply by calling them "chasing". It makes it sound unsophisticated. Only losers and simpletons *chase* stocks.

But guess what? Momentum is actually the best performing strategy you can employ—yet barely anyone does it.

Most investors are too wrapped up in debating growth vs. value. Yet when it comes to performance, both growth *and* value trail momentum. And no, I didn't just make this up. I've got data to back up that statement:

"Empirical data shows that momentum has indeed been a consistent long-term investment strategy," John Hancock's Frank Teixeira writes. "In fact, momentum factor returns have been stronger than those of either growth or value over the very long term, resulting in significant excess relative performance. Momentum averaged more than 3% in annual outperformance relative to the market from 1927 to 2014". Just look at all those growth and value funds.
Why is everyone pouring their hard-earned investing dollars into inferior strategies?



Because of their narrative filter… (cont.)

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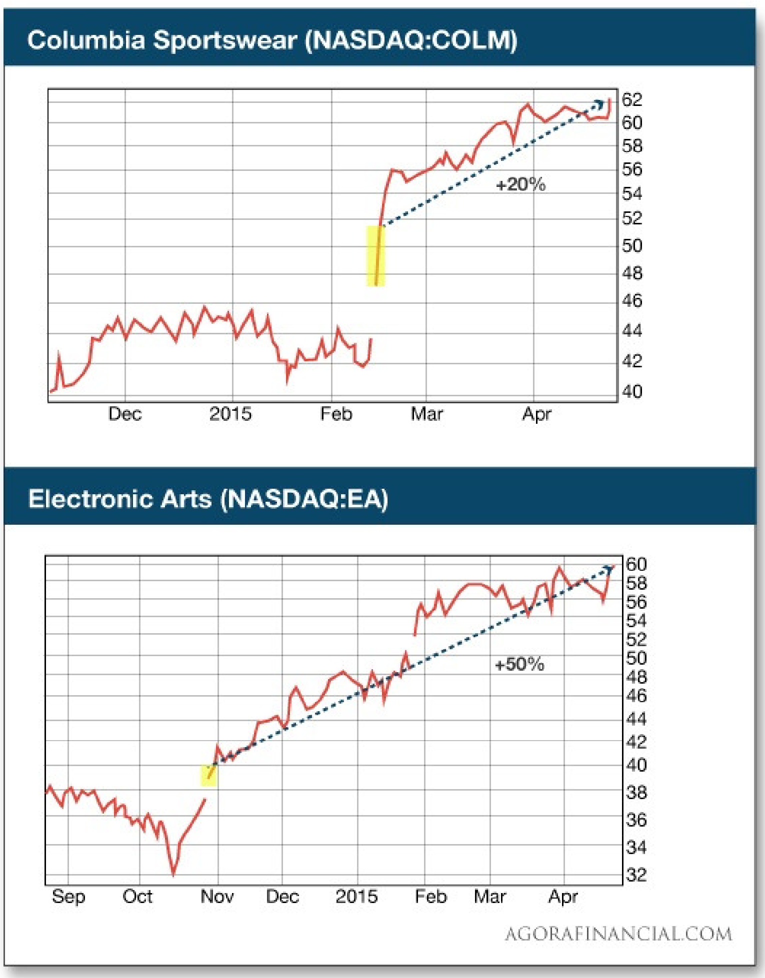
(cont.)

It's shockingly simple to force a growth or value strategy into your personal narrative. Growth is the easiest sell. It's all about stories. The next Facebook. The next Apple. Who doesn't want to own these ideas? And value appeals to our more rational emotions. I want to make money safely using a rigorous, academic approach. Again, how could you say no to that? The stocks that eventually outperform are the hidden, undervalued, unloved gems. It makes perfect sense.



But momentum? Buying the strongest stocks on the market and then just repeating this process over and over? C'mon. That sounds ridiculous. The whole idea of momentum investing is too simple. And nothing simple could possibly work in the cutthroat world of the stock market.

Except that's not true, either. While momentum sounds simple enough, it's not an easy strategy for most investors to employ. If you're actually running any type of momentum strategy and rotating into the strongest stocks on the market at any given time, you're buying a bunch of stocks most investors wouldn't touch because at a glance, they look overextended

Take a look at these two charts of stocks that broke out in late 2014 - early 2015:

Here we have two stocks that delivered crushing returns over a very short timeframe. But look at the highlighted spots. Those were your buy signals. Would you have forced yourself to buy these names as they surged higher? Hindsight shows us that they all offered stellar returns after these strong initial moves. But in the moment, most investors (and many traders) would have skipped over these stocks or attempted to wait for a pullback that never materialized.

It's not as easy as it looks.

But by all means, keep chasing returns with those growth funds. I wouldn't want to bust up your narrative…

Sincerely,
Greg Guenthner

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