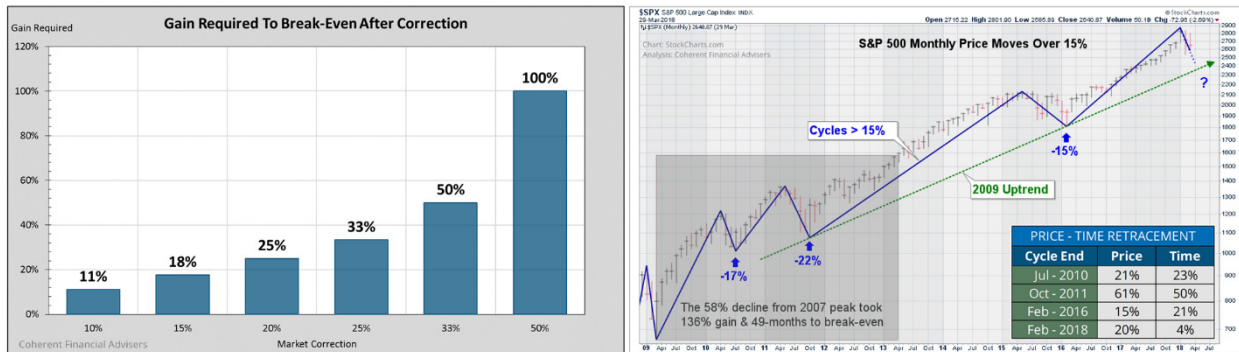


Manager’s Letter 2018 Q1

In the Star Trek episode, “Loud as a Whisper”, deaf mediator Riva suffers a personal tragedy while negotiating a bitter dispute on Solais-V. A dissident kills Riva’s “voice”, a chorus of three who speak for him. Riva must now draw on his negotiating skills to turn his disadvantage into an advantage.

While no investor who’s long the market enjoys a correction, negotiated properly, it can be turned to an advantage. After a correction, a passive portfolio requires a larger gain to break-even. It starts a recovery at a lower value than when it began the correction. As figure-1 illustrates, the portfolio requires a 33% gain to recover from a 25% correction. The deeper the correction, the greater the gain required. An actively managed portfolio can turn this disadvantage into an advantage.



Sources: sources are cited within each chart

Let’s say in a 25% correction, an actively managed portfolio loses 20%. This loss is recoverable in a 25% run-up instead of 33%. The 5% saved in the correction turns into an 8% advantage in the rally. And psychologically, an investor is less likely to sell at the point of maximum pain – the bottom!

Corrections have been relatively mild since the March 2009 bottom. Only three have exceeded 15% so far (figure-2). On average, each correction retraced one-third of its preceding up-leg in one-third the time. A fourth underway now has already swallowed 20% of preceding gains in 4% of the time.

The 2002-2007 bull market took 60 months to double, and less than 17 to give it all back and then some. It then took a 136% gain and another 49 months, 66 in total to break even. I am not expecting a repeat here. But I submit that the 2009 bull market has not yet corrected (green line, figure-2).

At Coherent, we focus on proactively mitigating downside risks by actively managing our stock market exposure. Our portfolio management philosophy and processes are continually honed to this purpose. We’ve been prepared going into the 2018 January highs, as we were in 2015.

Back on Solais-V, Riva begins teaching the warring leaders sign language. They learn to communicate with him and, in turn, with each other.

Warm regards,
Sargon Zia, CFA
April 4, 2018