

OUTSIDE THE FLAGS

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Weather Vs Climate

Notice how TV news bulletins put finance next to the weather report? In each, talking heads point at charts and intone about intraday events that are quickly forgotten. Meanwhile, the long-term wealth building story gets overlooked.

Many investors feel that they are not properly informed about the financial world unless they have checked daily, or even hourly, on how the Dow, FTSE, Nikkei or All Ordinaries have moved in the intervening period.

It's a pretty harmless activity in most cases. It at least provides a bland conversation starter in fleeting social encounters, just as keeping up to date with tomorrow's weather forecasts can fill an awkward silence.

But our very human focus on the day-to-day and the short term can often encourage us to make bad decisions that affect our long-term interests.

That's because while we experience the world moment-to-moment, what often affects us most are imperceptible, gradual changes that occur over many years.

Look at the way markets have begun in 2015, as reflected in daily news headlines from *Reuters*:

- Jan 6: Wall St in Longest Losing Streak in 13 Months
- Jan 8: Wall St Jumps for Second Day, Helped by Economic Optimism
- Jan 14: US Stocks Fall Heavily on Growth Concerns
- Jan 20: China Seen Posting Weakest Growth in 24 Years
- Jan 20: UK Stocks Gain on China's Growth

Trying to keep up with market sentiment based on news headlines like these is akin to watching Nadal versus Djokovic at the Australian Tennis Open. You're liable to get a crick in your neck keeping pace with the volleys.

The China GDP story is a good example. The curtain-raisers announced it would be the weakest economic growth number for nearly a quarter century. And, sure

enough, it was. But because the result was a fraction higher than what the market had priced, Asian stocks rallied.

As always, markets price expectations for events like this and then move on the degree to which the outcome varies with what is in the price. It is hard enough for professional investors to keep up with it, never mind a layperson.

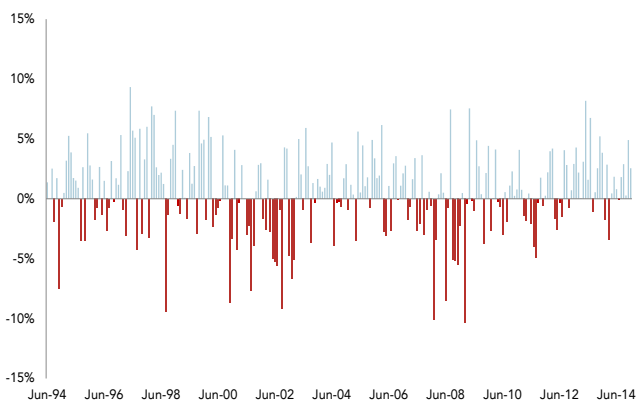
So from minute to minute, market sentiment shifts in reaction to news—news about the economy, news about companies, news about governments and politics and the wider world. Prices rise and prices fall in response to this news, which by definition is unpredictable.

To use an analogy, the market news is like the weather. One day it's sunny. The next day it rains. It's unseasonably warm one day and cool the next. The narrower is your frame of reference, the greater is the apparent variability.

Look at **Exhibit 1** below, showing monthly moves in a common barometer of the global share market, in Australian dollar terms. All you see are the monthly ups and downs—the regular changes in “the weather”.

Exhibit 1. THE WEATHER

Monthly % Moves in MSCI All Country World IMI Index (Net Div)



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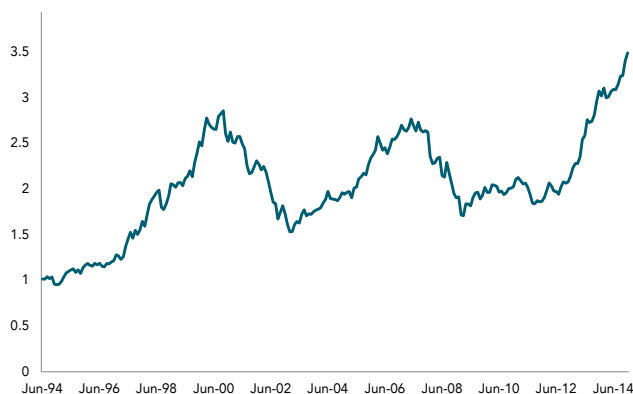
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Exhibit 2. THE CLIMATE

Growth of Wealth, MSCI All Country World IMI Index (Net Div)



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Another way of looking at this same measure (see **Exhibit 2** above) is to measure the growth of wealth. This way we are less focused on the day-to-day or month-to-month movements and more on how the wealth accumulates through time.

For a long-term investor, this is the more important measure because it takes into account cumulative gains. The media, by virtue of its publication schedule, must focus on short-term movements. They need a different story every day.

These two ways of looking at the market are like the difference between the weather and the climate. The former changes constantly; the latter more gradually. With long-term investment, it’s the climate you need to think about.



“Outside the Flags” began as a weekly web column on Dimensional Fund Advisors’ website in 2006.

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