A Case Study on Avenue's Equity Strategy vs. An Index

Why should one invest with Avenue as opposed to an index and why does Avenue not use index funds to gain exposure to some harder to invest in sectors? The simple answer is that the goal of Avenue's Equity strategy is to be more consistent than the index. We might not do as well in a strong stock market, but we will still do just fine. However, our strategy should do much better relative to the index over a full bear market cycle.

Index investing has been around for decades but its popularity has exploded in the last few years. The Financial Times of London reported that 80% of new retail investment went into index funds in 2016 and globally $1 trillion flowed out of traditional mutual funds and into index funds.

The argument for indexing is compelling. There is a 100% certainty that you will get the market rate of return. By simply investing in the broad market or a specific sector you are eliminating making mistakes by owning individual investments.

The problem is that the stock market is volatile. This is fine for most investors when the market is going up, but there are also sharp corrections. The bigger issue to us at Avenue is that there are also lost decades. This was most recently experienced by investors in the decade from 1998 to 2008 where the stock market compound return was negative. If you were retired and living off your investment portfolio, there was no benefit to taking on the extra risk of stock market investing for fully ten years. This is too long a time period for most people and the temptation will creep in that maybe investing was not a good idea in the first place.

Avenue's portfolio is not comparable over this time period given that we started in 2003. Our strategy is designed to be more consistent than the market but we only have the experience of the 2008 financial crisis to prove this. Avenue's equity portfolio performance over the 2008 financial shock was significantly better than the stock market index. Also, because of the cash flow within the portfolio, we had the flexibility to add to our investments at great prices as we went through the stock market decline.

To be more consistent than the index, what we do at Avenue is examine all available public companies to find the businesses that are more consistently profitable than the average company. Historical profitability is measurable and usually identifies which company has a better business. Avenue's job is then to understand if this business and its profits are sustainable and do they have the ability to gradually grow over time. This sounds simple but the challenge is to stick to the strategy and not get pulled off purpose by trends and emotion.