

# The Ambachtsheer Letter

Research and Commentary on Pension Governance, Finance and Investments

Letter # 271

August 2008

## INVESTING FOR THE LONG RUN:

### A 'MACRO' PERSPECTIVE

*“Even to the City’s most seasoned operators, what has happened over the past two weeks has been remarkable. We have witnessed such huge swings in share prices that the stock market looks like a casino....”*

John Waples  
The Sunday Times  
July 27, 2008

#### Resisting Inappropriate ‘Short-Termism’

Sunday Times’ business editor John Waples is not alone in worrying about the “huge swings in share prices” that seem to have become the order of the day. Many investors, both retail and institutional, are being drawn into a fearful ‘how much will the market fall today?’ state of mind, possibly leading to decisions driven by fear, rather than thoughtful analysis. We offer this, and the sequel September *Letter* as antidotes to the growing temptation to do something ... anything ... now. In this *Letter*, we examine the challenge of truly, seriously investing for the long run from a ‘macro’ perspective. We will show that its essence is coming to a clear appreciation of ‘macro risk’, and how it is priced over time. The September sequel will look at the challenge of investing for the long run from a ‘micro’ perspective. The logic there will be that even with a good sense of how ‘macro risk’ is being priced today, and how it might be priced 5-10 years from now, further decisions about the types of risk exposures offering the best reward opportunities must still be made.

Before diving into the promised subject matter of this *Letter*, there is a further important point to be made. Not all individuals or institutions can afford to be ‘macro risk’-bearing long term investors. If an investment portfolio is the main funding source for retiree essentials such as food and shelter today, there is little capacity for bearing investment

risk even in the short term. Similarly, if a collective DB pension arrangement is underfunded today and does not have a ‘deep pockets’ risk underwriter, there is once again little capacity for risk bearing even in the short term. So to be clear, ‘short-termism’ (in the sense of needing to closely match assets and liabilities) is the proper mindset for people or institutions with little or no risk-bearing capacity. Only people and institutions with the economic ability to withstand material capital value fluctuations in their personal or institutional balance sheets have the option to consider risky investment strategies. Only they should be keenly interested in how ‘macro risk’ is being priced today, and how it might be priced 5-10 years from now.

#### Understanding ‘Macro Risk’

The essence of important investment concepts such as ‘macro risk’ can be grasped by thinking through simple thought-experiments. The starting one here involves Simple Land, a country with skilled work force and a single publicly-traded company Simple Co. that produces all goods and services Simple Land’s population requires. Through share ownership, the population owns Simple Co. The population earns \$700 billion in wages. Simple Co. has gross revenues of \$1 trillion, which equals Simple Land’s GDP and National Income. Simple Co.’s earnings are \$300 billion.