viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

spring 2021 newsletter

Investing vs. Trading

A year ago, we were dealing with a market that was pulling back due to the great unknown of the COVID-19 outbreak. The S&P500 hit its low on March 24, 2020 – off 28% from its all-time high set earlier in the year. Yet today the market has not only recovered from the pullback, but it is also 33% higher than it was before the pandemic started.

The last 12 months have certainly been favorable for both traders and investors. While traders and investors both attempt to profit by investing in the financial markets, their gains – and losses – usually occur for very different reasons.

Investors look at building wealth over time by investing in a diversified portfolio of stocks, bonds, mutual funds and exchange traded funds. Their portfolios vary depending on risk tolerance, time horizon and needs. They purchase securities with the idea of holding them for several years and will usually hold through market-ups and downs. Fundamentals drive their investment decisions, not short-term market fluctuations. Capital gains taxes for long-term investors are either 20% or their income tax rate, whichever is lower. Volatility is neither good or bad for investors if they do not let emotions affect their ability to hold their investments through multiple market cycles.

Traders, on the other hand, use short-term strategies to try and make money. They attempt to make transactions that can help them profit quickly from fluctuating markets. They will jump in and out of stocks often - sometimes even selling a security on the same day it was purchased. Traders focus on trends and/or technical factors, they rarely care about the name of the company they are buying. Profits are usually short term and are taxed at income rates which are up to 35% in taxable accounts. Volatility is good for traders as it gives them more frequent trading opportunities.

Marshall & Sullivan is an investor. Our average holding period is over 5 years. When buying a security, we do not just focus on past or current earnings. Instead, we look at items that might get in the way of future earnings growth: finances, management, governance, economy, environmental issues and competitive factors. We sell investments when they become too large of a percentage of the portfolio, or earnings quit growing, or they become too expensive, or there is a material management change that might affect the future growth of the company.

2020 was a good year for investors like us because we focus on companies with growing earnings that are fairly valued. At the beginning of the recovery, it was the stay-at-home stocks that led the market higher because they were perceived to be able to grow their earnings during the pandemic. Stay-at-home stocks were companies like Zoom, Microsoft, PayPal, Amazon and Peloton. Many became very expensive compared to their earnings, causing investors like us to trim or sell some or all of these positions if they were invested in them.

Beginning in September of last year, when it looked like COVID vaccines were likely to be approved, we saw a big change with the market leaders. Traders started to sell stay-at-home stocks and bought recovery stocks. Highfliers like Zoom and Peloton are now down 40% or more from their highs. Even stalwarts like Microsoft and Apple dropped over 10% before starting to recover. If traders timed their buys and sells correctly, they made good money. If not……

Now it is the recovery stocks that are expensive. Darden, the largest player in casual dining, with restaurants like Olive Garden, Yard House, Capital Grill and others is a good example. Darden is 31% higher today than it was before COVID started, despite many of their restaurants being restricted to 50% of capacity in many states. If you were a trader and got in early you are happy; if you are just now buying these stocks, not so much.

We are not sure what is next for traders; however, for investors like Marshall & Sullivan, we know we will be sticking with our disciplines that focus on long-term portfolio growth. We believe our process has treated clients well over the last 40 years and we see no reason to change.

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