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Law of Inertia

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Dear Investors and Partners,

As we all know, Sir Isaac Newton gave us the famous three laws of motion, among which the first law in a simplified manner, states that an object at rest will remain at rest unless an outside force acts on it, and vice versa. This law is also commonly known as the Law of Inertia.

Now you may be wondering why I am discussing Newton in a mutual fund newsletter and what it has got to do with investing. As a firm believer of behaviour-based investing, I think inertia plays a very crucial role in the long-term outcomes for an investor. The outside forces will disrupt the steady state every once in a while, but an investor or advisor who can maintain inertia in a positive sense, will have a better chance, in my opinion, to create wealth over the long-term.

But don't take my word for it. Let's look at some studies worldwide which highlight investor's activity, or the lack of it.

A study by Vanguard Group & Fidelity found that investors who held their equity investments for more than 20 years and 10 years respectively outperformed the investors who frequently traded. As per annual studies titled Quantitative Analysis of Investor Behavior (QAIB) done by Dalbar Associates since 1984, focused on analyzing investor behavior in the U.S., they found a recurrent theme every year which highlights that an investor tends to be his own worst enemy when it comes to investing behaviour. Performance chasing, attempts at market timing, focus on short-term causes an average investor to underperform over a period of time. As per their study as of end 2022, an average equity investor in U.S. earned a CAGR of 6.81% over a period of 30 years, underperforming the S&P 500 significantly which generated returns of 9.65% in similar time frame. (Source: Dalbar QAIB 2023 study, Morningstar Inc) This also highlights the fact that an advisor, apart from being a financial coach to the investor, needs to also double up as a behaviour coach and the greatest value add can be discipline and commitment towards long-term financial journey. Back home, a recent study by SEBI brought out that 9 out of every 10 derivative traders in India are losing money in the stock market. (Source: SEBI)

Coming back to Sir Isaac Newton, recall that even he was not successful at market-timing in his infamous investment in South Sea Company bubble of the 1720s, which led him to comment "I can calculate the motion of heavenly bodies, but not the madness of people".

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