

A SYSTEMATIC APPROACH TO EXTREME STOCK MOVES

Certain individual stocks have seen extraordinary market moves in the past few weeks. Read about how Bridgeway continues to rely on a systematic approach built for these moments.

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By **Andrew L. Berkin**, PhD
Head of Research

John Montgomery
Founder and Chief Investment Officer

Christine Wang, CFA, CPA
Portfolio Manager

Unless you have been living in your bed, bath, and not much further beyond, you may have noticed some unusual stock activity recently. Whether it's single stocks that jump in multi-fold like a game that won't stop or just sitting back watching the movie plot unfold, it seems like everyone wants to express an opinion one way or the other.

We've been getting many questions about how this activity has impacted our portfolios and wanted to summarize our viewpoint as a statistical, evidence-based manager.

Statistical, evidence-based investing may sound intimidating, but at the most basic level, it's defining quantitative rules and then systematically applying those rules in your investing process. At Bridgeway, we believe that factors shape returns. Factors are nothing more than themes or characteristics of groups of securities, such as stocks. We have followed a systematic process for the past 28 years. That doesn't mean crazy stuff can't happen in the short term, but we believe that fundamental characteristics explain stock returns over the long term. Thus, the reason why we would enter a position is not going to be based on speculation, but due to a factor or theme that we believe in, such as value, company financial health, momentum, and size.

We also believe in diversification in many aspects. That means we diversify not only our factor exposures, models, and holdings but our team. One of the main reasons for diversification is risk management. A well-diversified portfolio limits the potential downside exposure to any specific name. This would also apply to the upside as well. If a stock has a large move up, we will consider trimming it for risk considerations to continue to meet the portfolio's desired exposures.

While we get most asked about how stocks enter our portfolio, determining how names exit is just as important. Every position established at Bridgeway adheres to a set of disciplined sell rules. Does that mean that we just set it and forget it? Of course not. We are continually monitoring positions and movements. There's the chance that earlier action will be taken due to risk considerations, tax consequences, or other portfolio changes, such as if the reason why we bought the stock no longer holds. These considerations are quantified and set ahead of time; decisions are not made on the fly when emotions and other behavioral biases may be at play.

This rules-based flexibility highlights a benefit of systematic investing versus pure indexing. If you are tied directly to an index, by and large, that flexibility no longer exists. To track an index, you must buy and sell precisely when the index dictates, even if that means buying at the high and selling at the low.

Does this mean we will get it exactly right every single time? It might be surprising to say – but probably not. Especially with speculative cases, it may be tough to nearly impossible to hit the top. But the discipline of our investment process allows us to have a set process in place, realizing gains along the way without putting the portfolio at extreme risk. We humbly know that there's always more to learn and believe in the process of seeking continuous improvement. We stay curious, in line with our principles of relational investing.

I know we all love stories, and often that extends to story stocks. But a disciplined, systematic process will allow you to invest well, sleep well, and leave the entertainment in the theatres.

If you would like to share a story or have a question for a member of our Client Service and Marketing team, email us at info@bridgeway.com or call 713-661-3500, option 1.

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