Columbia Business School

# Buying Low and Selling High

Andrew Ang

Ann F. Professor of Business and Chair of the Finance and Economics Division

Columbia Business School

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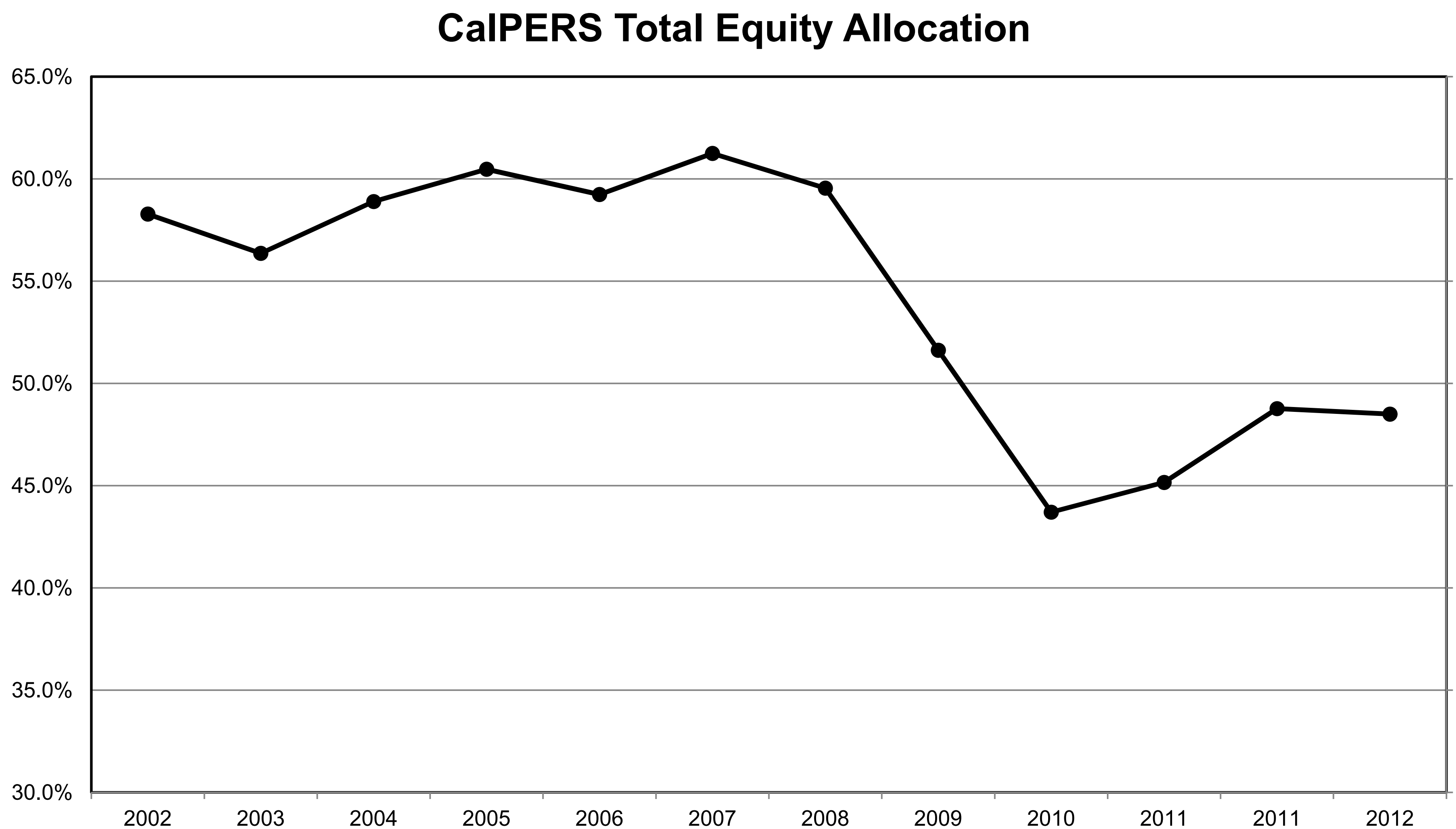
# Ain’t So Easy

- Buying low and selling high is how *any* investor, long or short horizon, makes money

- Being *counter-cyclical* goes against investors’ behavioral tendencies
- Most investors are pro-cyclical, and chase returns. They invest precisely at the wrong time: when prices are high, investors are drawn by *past* high returns, but *future* expected returns are low.

# Investment Mistakes at CalPERS




From “California Dreamin’: The Mess at CalPERS, Columbia CaseWorks, https://www8.gsb.columbia.edu/caseworks/node/359

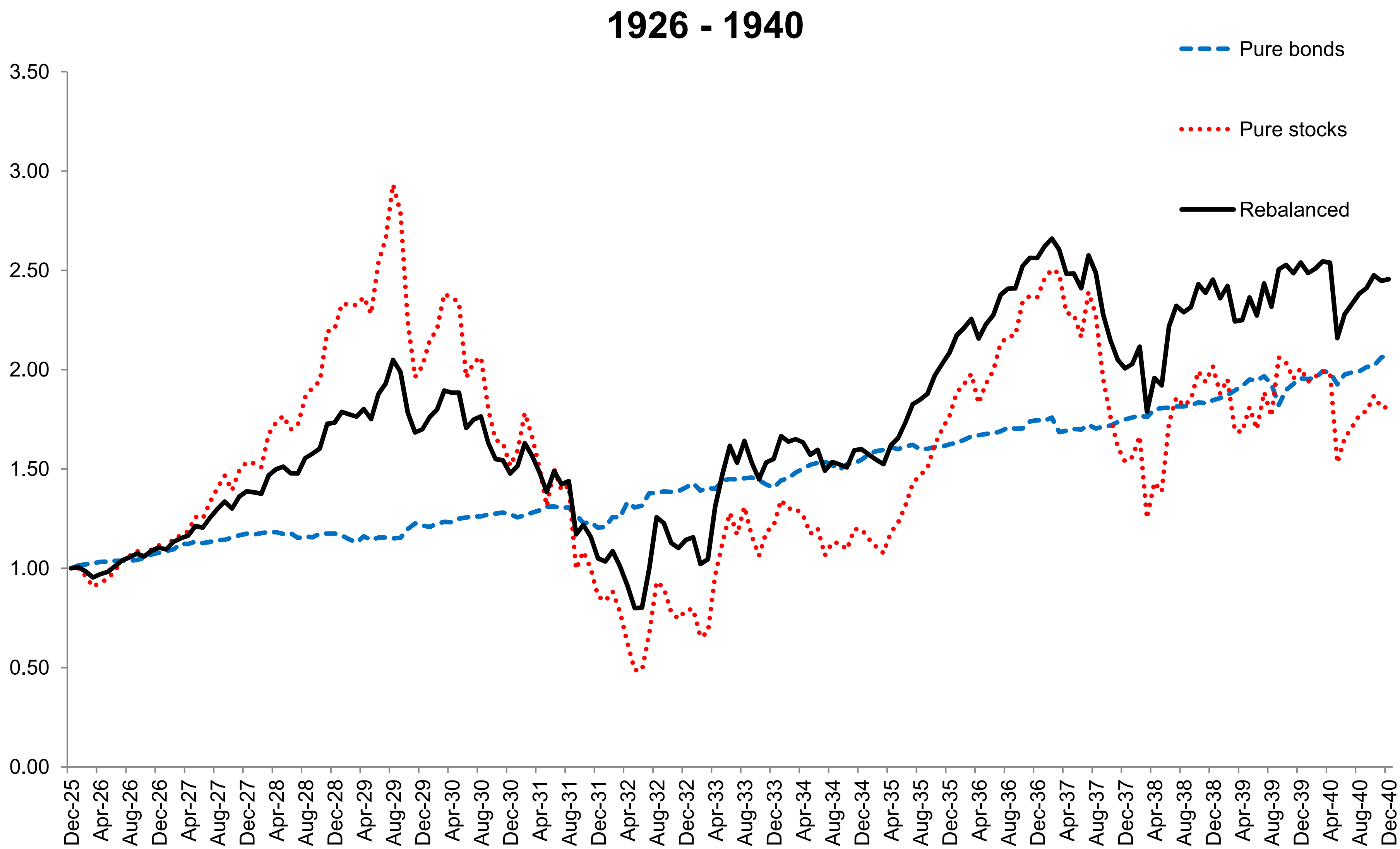
# Rebalancing Buys Low and Sells High

- Rebalancing to fixed positions is the foundation of long-term investment strategies
- Optimality of rebalancing was shown by Paul Samuelson and Robert Merton (who won Nobel Prizes in 1970 and 1997, respectively)
- Rebalancing buys low and sells high:
  - Cuts back on risk as prices rise
  - Increases exposure when prices fall

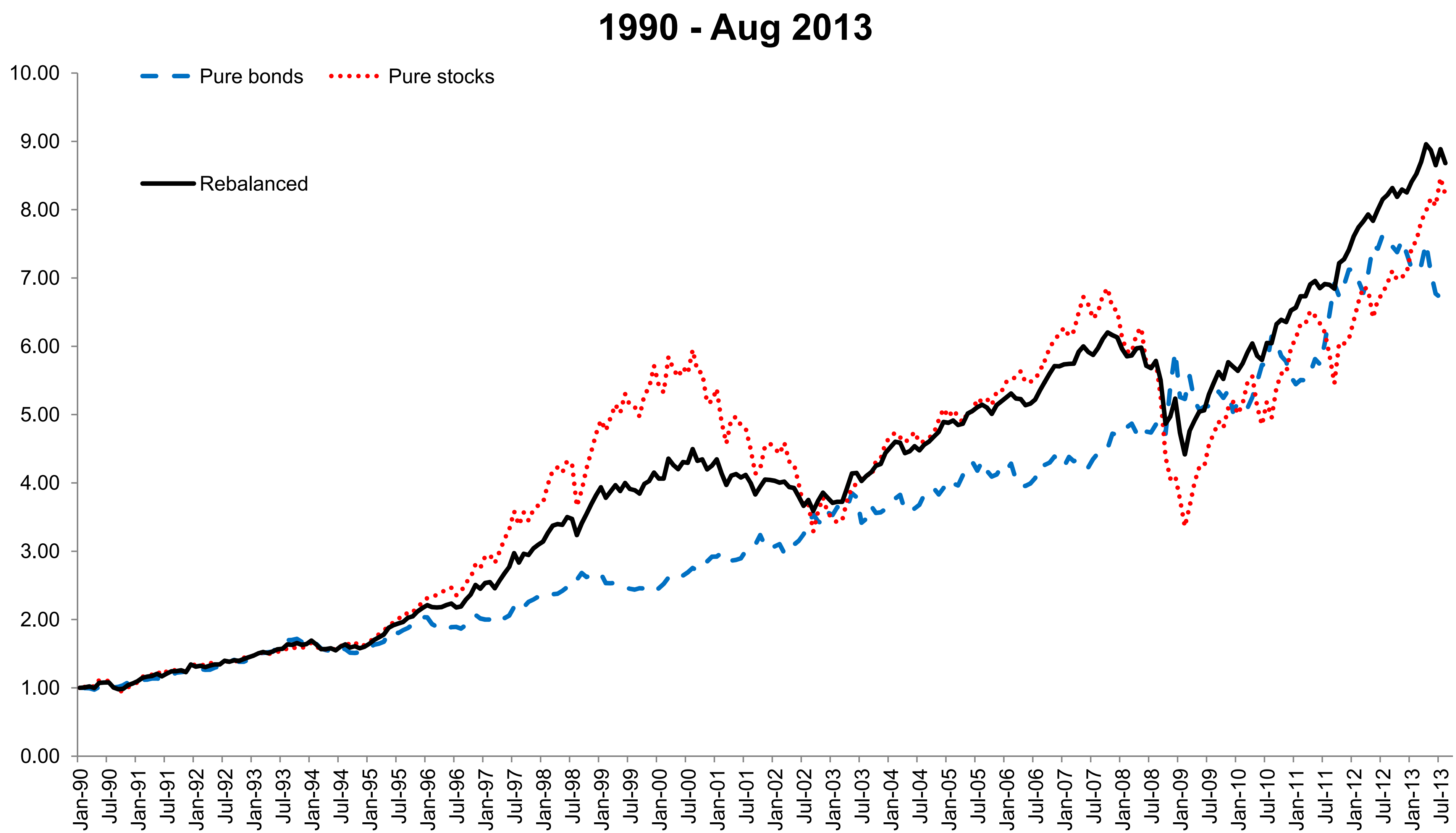
# Rebalancing Buys Low and Sells High

- Long-term investing fallacies
  - A long-run investor never buys and holds
  - Long-term investing is first and foremost about being a good short-term investor
- Additional benefits of rebalancing
  - Ride out short-term fluctuations in risk premiums, and profit from periods of elevated risk aversions and mispricing
  - Acquire distressed assets when investors with over-stretched risk capacity or constraints have to sell
  - Most effective method of harvesting a liquidity premium

# Rebalancing: Great Depression



# Rebalancing: Lost Decade



# Rebalance!

- Rebalancing rule = Buy low, sell high

- Superior weighting schemes incorporate *valuation* information, allowing investors to act even *more counter-cyclically*
- Buy even more when prices are low and sell even more when prices are high, but rebalancing is the baseline case
- Extend rebalancing to *dynamic factors*, similar to static equity-bond factors