EFFICIENT GROUP

ECONOMIC COMMENTARY

- Dr. Francois Stofberg, with specialist input from Christiaan van Wyk

YOUR WEEKLY ECONOMIC UPDATE

19 September 2023

BOTTOM-UP AND TOP-DOWN INVESTMENT STRATEGIES

The investment industry, like most other professions, has evolved over time with various approaches and strategies coming to the fore, each with its own inherent characteristics. When investing in listed shares, two dominant approaches stand out: Fundamental bottom-up and top-down investment strategies. These approaches represent distinct methodologies for selecting and managing investment portfolios, each rooted in a unique perspective and analysis framework. Fundamental bottom-up investing is based on the scrutinisation of individual assets or securities, assessing their intrinsic value, and making investment decisions based on the merits of each specific opportunity. Conversely, top-down investment strategies take a broader macro-economic viewpoint, where investors first evaluate global or sectoral economic trends and then identify industries likely to benefit from those trends before honing in on specific investments. Understanding these two contrasting approaches is crucial for investors seeking to tailor their strategies to their investment goals and risk tolerances.

Fundamental bottom-up investing offers several benefits. One of the primary advantages is its ability to provide a deep understanding of individual securities. By focussing on the intrinsic value of each investment, investors can potentially identify undervalued opportunities and make well-informed decisions based on the specific strengths and weaknesses of each company. However, fundamental bottom-up investing also has its drawbacks: It can be time-consuming and resource-intensive, requiring extensive research and analysis for each individual investment. This approach may not suit investors who prefer a more hands-off or passive approach to managing their portfolios. Moreover, it can be challenging to anticipate macro-economic trends or market shifts that could impact the performance of individual assets, as the focus is primarily on micro-level analysis.

The top-down approach, in turn, is primarily centred around its macro-economic perspective, allowing investors to assess global economic trends, sectoral developments, and broader market conditions. This strategic outlook enables investors to allocate their capital effectively and to capitalise on emerging opportunities, potentially yielding higher returns. Furthermore, top-down investors can adapt their portfolios to changing economic climates, making it a flexible approach when navigating market volatility. However, top-down investing is not without drawbacks. One significant challenge is that it may lead to overgeneralisation and missed nuances, as it emphasises broader trends over individual asset analysis. Investors relying solely on top-down strategies might overlook potentially lucrative opportunities within specific sectors or companies. Additionally, accurately predicting macro-economic trends can be exceptionally challenging and even small miscalculations can have adverse effects on portfolio performance. This approach can also lead to a lack of diversification if investors become too concentrated in a particular sector, increasing portfolio risk in the event of unexpected market shifts.

We, at Efficient, believe that the best approach to managing equity portfolios is to balance the macro-economic perspective with careful stock selection, which increases the investor's potential to achieve favourable long-term returns. An investor must understand the underlying drivers of profitability for each company that they invest in, as well as the price that they pay for their share in those profits, while also managing the overall portfolio risk by comparing the portfolio exposure with the expected economic climate and secular themes at play. As with most things in life, finding an appropriate balance often leads to optimal outcomes.