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Why do stock markets fluctuate so much?

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I am often asked why stock markets fluctuate so much. To answer this question, one must first understand what a stock price represents – the value of a company as determined by investors of different styles and investment backgrounds.

Investors have different views, which is why some may choose to buy shares of a company while at the same time others may choose to sell. Some investors buy and sell stocks based on news, while others buy and sell based on research and analysis. Some investors may choose to follow an index and hold the same stocks at the same weightings. This type of investing helps to drive short-term inefficiencies in the market as stocks are purchased at any price and held without conducting any research. In Canada, Nortel, Research In Motion and Valeant Pharmaceuticals are examples of companies that were once the largest holdings on the Toronto Stock Exchange. Nortel is now worth zero, and Research In Motion and Valeant Pharmaceuticals are trading at a fraction of their peak share prices. In our opinion, these gains and losses were driven mainly by investors' irrational behaviour (for example, greed and then fear).

Investment professionals also have different investing styles. Some invest based on the growth potential of a stock and some invest based on the perceived value. Each investment style may lead to a different investment decision.

While buyers and sellers, or the forces of demand and supply, determine a stock price in real time, the long-term value of a company is driven by its earnings and cash flows. If you purchase a company's stock at a reasonable price, diversify your holdings and be patient, the outcome can be fairly predictable. The return of a stock investment is influenced by three factors: the dividend, future earnings growth and valuations. If a company pays a 2% dividend and has earnings growth potential of 4-6%, the long-term return is expected to be 6-8%. A company's valuation is the most unpredictable factor in the short term, and at extremes is driven by greed and fear. Earnings are the second most unpredictable factor. Even if a company grows 4-6% annually on average, the growth rate will not be consistent each year as a company goes through economic and product cycles. When earnings are above average, the stock price tends to rise and decline when earnings are below average. Dividends are usually the most stable factor as they typically remain consistent through economic cycles.

Our Multi-Asset Management group and the portfolio managers we work with tend to focus on valuations and earnings growth as the primary factors that influence returns. We research and analyze the fundamentals of a company and invest in those that we believe are undervalued by the market. We also recognize that the world may surprise us with natural events, regulatory changes, and more. As a result, we diversify our holdings to limit stock, industry or country-specific risk. Most importantly, we remain patient while we wait for our investment thesis to play out. Other market participants may have an opposing thesis and this can create volatility in prices. However, despite short-term fluctuations, our research and analysis gives us confidence in our long-term expectations.

Combined top 15 equity holdings as of June 30, 2017 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. Microsoft	6. Apple	11. ICICI Bank
2. Canadian Natural Resources	7. E-L Financial	12. PrairieSky Royalty
3. Atco	8. Suncor Energy	13. Walgreens Boots Alliance
4. Altagas	9. Bank of Nova Scotia	14. Wells Fargo
5. SNC-Lavalin	10. UnitedHealth	15. Alphabet Class C