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# Investment ideas during tough times

by Ang Kok Heng



means to ride the recovery of the stock market as they will most likely be the first to recover when foreign funds return.

**T**he collapse of Lehman Brothers in September last year generated a domino effect and drove more financial institutions into financial distress. The financial landscape turned ugly immediately since then. Fear of depression resurfaced. Central banks worldwide cut interest rate simultaneously and increased stimulus packages to save the global economy. The sharp plunge in stock prices caused massive losses to some but provided "once-in-a-decade opportunities" for those who have been waiting for bargains. In line with the sharp contraction in imports following fears of reduced consumption, commodity prices also plunged.

While volatility and credit crisis has improved much, the worst may not be over and investment risk could still be high, at least over the immediate term. On the other hand, potential gain could be high for those who hit it right or have the holding power to ride through this crisis.

**Possible events & investment options**

Under different scenarios, there are different investment options. It is a matter of which event will happen. If it does happen, what will be the appropriate investment strategy to take advantage of the outcome? Some ideas are shown below.

**(a) Stock recovers before economy**

In line with deteriorating economies and falling corporate earnings, stock prices fell sharply. Part of the fall in price was due to falling fundamentals. The other contributing factors for the 50%-60% drop in stock prices include anticipation of further deterioration in the economy, exodus of foreign funds as well as distressed disposals by highly geared investors/owners and reluctant disposals by funds to meet redemption.

In terms of valuation, stock prices are cheap based on various aspects of measurement. The fear of further losses among investors (as usual in the greed and fear cycle) prevented some who have the capacity to invest from buying.

As a barometer of the economy, stock prices will recover before the economy recovers. If IMF is right, the global economy should recover early next year, stock market could bottom six months ahead or middle of this year. Thus, the opportunities to invest in stocks could be in the next quarter.

**(b) Discounted blue chips**

The present crisis provides opportunities for investors to acquire some of the blue chips at discounted prices. Well-managed blue chips will eventually recover and the management will implement appropriate measures such as cost cutting, rationalisation to minimise the fall in earnings during the current economic crisis. Some of them may even take advantage of the crisis to expand market share by acquiring rivals.

As blue chips are well supported by institutional investors and they seldom trade at cheap valuation, the present crisis is a blessing for those who intend to buy some blue chips for long-term investment. If not for this crisis, some of the blue chips will not be trading at low teens/single-digit valuation.

Blue chips are also an excellent

**(c) Bluest of the blue chips**

While Malaysian stocks have fallen, foreign markets have fallen even more. There are many blue chips and well-known brand names in the Far East as well as in Europe and US which are trading at discounted prices. If we ignore banks that have toxic assets and waiting for government rescue, there are many bluest of the blue chips that are on the "cheap sale" list. These stocks have excellent management systems, global brand name, established business network and global competitive advantage.

Following the opening of investment door for Malaysians to invest overseas, there are much more opportunities outside the country if we can do some research. Some of the ideas include PetroChina and China Mobile from China, BHP from Australia, Great Eastern and Wilmar from Singapore, Microsoft and General Electric from US, Tesco from UK, etc.

**(d) Bombed-out stocks**

With our market down 40%, many stocks fell even more. Some plunged as much as 70%. If the collapse in price is not due to change in fundamentals but due to some desperate investors or funds to meet margin call or fund redemption, there will be opportunities to pick some cheap bargains. There are many penny stocks trading below RM0.50 having fair fundamentals. They could be in Mesdag, property or construction-related companies. So long as these companies still have positive cashflow and will survive the current financial crisis, they could be bought like warrants but have no expiry date. Some of them could yield double or triple in gain when the market recovers in few years' time. Since immediate recovery in price could be difficult in view of the still-poor market sentiment, slow accumulation could be more appropriate.

**(e) High-yield stocks**

During the period of uncertainty, some investors may want to stay cautious. Stocks which pay high dividend will be well supported and hence their share price could stay firm. Companies paying high dividend must be financially strong and the earnings must be "real". It is because of this that companies that pay consistently high dividend over the years have lower risk relatively.

When choosing this type of stock, it is important to ensure that its business and cash flow are sustainable to support the dividend payment. As such, looking at the historical dividend yield alone is not sufficient to conclude whether a stock is suitable for dividend play. A good example is plantation stocks, which paid high dividend last year due to bumper profit from exceptional high CPO prices, but are unlikely to declare similarly high dividend this year. With reduced foreign purchase of US bonds, the only way is for US to print more money.

**(f) Commodity recovery**

Jim Rogers is a long-term bull of commodities. The rationale is simple. Over long term, the limited supply of commodities and the gradual growth in demand will only push commodity prices higher. Recent evolution of China and also several emerging countries like Vietnam and India from primary agriculture economy to secondary economy of manufacturing requires substantial amount of basic materials. The pressure on supply will lift commodity prices higher over time.

Although the present economic slowdown will put a brake on de-



Malaysians can now invest in companies such as China Mobile following the opening of investment door for Malaysians to invest overseas. Photo by Bloomberg

mand, it is only temporary. After this global recession, manufacturing powerhouses will revive their production and supply of raw materials will be under stress again to meet the growing demand. As such, the uptrend cycle of commodity prices is likely to continue again after the present setback.

As for soft commodities, the swelling population worldwide as well as the growing affluence in populated economies, especially China and India, will increase the demand for many food items such as wheat, corn and vegetable oils. With limited arable land and limited scope to increase productivity, supply is under pressure to meet growing demand. The tight stock/usage ratio is very sensitive to any short-term narrowing of the supply-demand gap. Due to the limited substitute over short term, the consumer habit of consuming the same commodity normally resulted in inelastic demand. Any disruption to supply due to weather, for example, will lead to a sharp surge in the commodity price.

Another major factor supporting the bullish view for soft commodity is that the affluent generation in emerging economies has started to consume more dairy products and meat. The high grain-to-meat conversion ratio means that much more grains such as corn and soyabean must be produced to feed the cows and poultry to generate the required animal protein for the affluent society.

As such, buying commodity, be it hard or soft, is a compelling investment idea. There are several local unit trust funds offering this exposure.

**(g) Weaker US\$**

US is expected to start printing huge amounts of money to feed the financial system and to fund its stimulus packages. With interest rate having fallen to its floor, US has used up its last card of monetary policy. Since interest rate cannot fall below zero, the only way to prevent a depression is to flood the market with more money. The low interest rate will make fund raising via bond issuance difficult. Bond has been the traditional source of funding to finance growing US trade deficits. With reduced foreign purchase of US bonds, the only way is for US to print more money.

Additional supply of greenback will only weaken US\$ simply based on the economics of supply and demand. Even the fear of more US\$ flooding the market and her inability to raise money through selling more bonds to foreign buyers will exert downward pressure on the greenback.

It is not inconceivable that one day investors will abandon US\$ and head for the exit. When that happens, more investors will join the flight as they do not want to be left behind. As such, it is highly probable US\$ will weaken soon. When that hap-

pens global financial landscape will change again.

Commodity such as crude oil will be the first to take the excuse to move up. Then other currencies will appreciate vis-à-vis US\$ — some will gain more, others will gain less. The outflow of US funds has to find a home. Some will go into government bonds and some will end up in equity market.

There are many ways to take advantage of a weaker US\$ — buy commodity funds, increase investment in equity funds or hold non-US currencies. The reversal of flow of money from US will benefit Asian market which is probably the only region which is still financially strong yet without much toxic debts and still has some growth due to improving domestic spending. With stock prices having fallen by 50% or more and currencies by 10%-20%, Asian market has become very attractive to foreign funds. As such, when the US\$ starts to weaken, the outflow of US funds will benefit Asian stocks the most. One investment idea is to buy Asian unit trust funds such as Greater China fund, Asia-Pacific emerging market fund and country ETF which are listed in US, Hong Kong and Singapore.

**(h) Safe haven gold**

When US\$ weakens, gold is perceived as the safe haven, at least in the eyes of most people. In a way, gold moves in inverse correlation to US\$.

After the collapse of commodities in July 2008 led by the plunge of crude oil price, most commodity prices fell in tandem, except for gold and precious metals which fell less. Gold price has been holding firm despite weaker demand following the weaker global economy and an overhang of supply from the disposal by several central banks over the last few years when gold price was rising. After gold price crossed 1980 high of US\$834/roy oz, more people are convinced that gold is a good medium to preserve capital.

Unlike other forms of investment, there is no income for gold investment. The only form of return is capital gain. If gold price does not go up, there is an opportunity cost. Fortunately, with the recent sharp cut in interest rates, the opportunity cost is low. The low interest rate will remain so for the next few years. When interest rates become high again one day, the attractiveness of gold may lose its shine.

Investors wanting to have exposure to gold could buy gold jewellery. But the mark-up in workmanship at the point of purchase as well as the abatement of up to 15% at the point of disposal, make jewellery a bad investment medium. A more efficient way is to invest in gold savings account offered by some local banks. They come in smaller denomination and can be purchased or disposed easily. The transaction cost of 4%-5% is still reasonable for

longer term investment. The main advantage of this form of gold investment is convenience and there is no maintenance required to keep the gold in a safe place.

For more serious investors, purchase of Gold ETF (GLD) is much cheaper. GLD is the world's largest exchange-traded gold fund backed by gold bullion with market capitalisation of about US\$15 billion. It is quoted at several major stock exchanges including Singapore, Hong Kong and New York. It is quoted at 1/10th of an ounce. Transaction cost could be as low as 0.4%. The ETF does not invest in gold mining companies whose share price may behave differently from that of gold and they are not suitable to mimic the performance of gold.

**(i) Forced-sale properties**

In every crisis, there are bound to be opportunities in the property market. Some investors could be forced to sell some properties at distressed price. Unlike during the Asian financial crisis where interest cost was high and banks were pulling back loans, present financial crisis will only affect those who are over-gearred or those who are forced to sell their properties to cover losses in other areas. Forced-selling of properties in this crisis will not be substantial except in areas where a bubble has developed over the last few years. The most obvious are properties around KLCC area.

With more cash-rich investors eyeing distressed properties, competition is likely to be keen for those who intend to have a hand in it.

**(j) Bearish investment**

With the deteriorating economy, increased unemployment, reduced consumer spending and higher defaults by corporations, banks are likely to curb lending. There is also a possibility that the expected recovery of the global economy by early next year may not materialise. Cash could be the safest place to be but with the current low interest rates, one can also look at investing in short-biased hedge funds which profited from forward sales of stocks and financial instruments. Another alternative is to invest in managed futures which returned double-digit gains last year from shorting commodities, currencies and stocks. They are likely to perform well again if the financial markets continue to be volatile this year.

The above investment ideas are just some of the suggestions. Some of them may happen, others may not happen or may be delayed. Each outcome is like a bet as it may or may not happen. Each outcome carries with it a probability. If one believes in an investment idea, then some allocation can be made on the bet. An investor may adopt a number of "bets" to spread out the risk. The amount to allocate to an investment idea will very much depend on the belief that the event will happen. Likewise, no allocation should be made on an investment idea if it is believed to be unlikely to happen. An allocation to an investment idea should not be made in the form of one bullet investment. Several tranches could be made to spread out the investment in order to mitigate timing risk. For example, if one intends to allocate 10% of asset in gold, the investment could be made in three tranches, say one-third every two months.

Ang has 20 years' experience in research and investment. He is currently the chief investment officer of Phillip Capital Management Sdn Bhd.