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Strategy During Crisis Investment

Prices may fall but the values of these companies are still very much intact.

This article is regarding the current US financial crisis. Investor confidence is low and people rather save their money in banks instead of risking it further. However while the money is safely out of the way, profit opportunities arising may be missed. There are several strategies that one can take advantage of the current crisis.

Prices Fell but Value Intact

Presently stock prices have fallen sharply. Many banks are trading at 1x book value, property stocks sold at 50% discount from net asset value, utility stocks trading at single digit price-earnings ratio, stocks providing earnings yields of more than 10% net of tax and there are many good stocks trading at dividend yield of 2x bank interest rates.

While prices have fallen off the cliff, the values of these companies are still very much intact. The present financial tsunami in US has its impact on many Malaysian companies. It will cause a slowdown in our economy and affect earnings over the next one to two years. But isn't this part of business risk? Established and proven companies have weathered this many times as in the past and they will eventually end up bigger and stronger.

Prices may fall but the value of a good company is still very much intact. The value of a company comprises of the brand name, business contacts, the team of suppliers, the network of clienteles, the internal management control, the technical skills and etc.

Warren Buffet is Busy Buying

Warrant Buffett, the second richest man in the world who makes his fortune from stock investment, is busy buying undervalued companies. He sees the value and he also sees prices detaching away from the intrinsic values. He said, "*I haven't the faintest idea as to whether stocks will be higher or lower a month – or a year – from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up*."

Although we may not be able to imitate exactly what he is doing, we can still follow some of his investment strategies. There are a few strategic moves that he has employed in the current financial crisis:-

- He is able to buy those shares which he likes in the past at a huge discount to the net worth, which means his safety margin at this point is very good.
- He aims to hold the investments for several years for huge profit margin as he is unlikely to sell for a small profit.
- He does not rush in to buy, he is very selective in the stocks he bought.

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Catching a Falling Knife

Markets do not stay at the bottom waiting for investors, it will move on.

Some may argue that buying now is like catching a falling knife. If you are not careful, you may be hurt and suffer more losses from falling stock prices. There is no doubt that we may incur short-term losses as long as we do not buy at the bottom. On the other hand, who can determine where and when is the bottom. As long as there are still unknown events or hidden problems, an apparent bottom now may not be the eventual bottom. Since we do not have all the information in the market, it is almost impossible to guess where the bottom will be.

In most cases, we only realise the bottom after it is over and by that time stock prices are running high with much improved market confidence. Market bottom could be there only for a short period. In most cases, market did not stay at the bottom waiting for investors. It will just move on.

Since market moves ahead of the economy by about six months, market bottoms out when the economy is still gloomy, news are still negative, analysts are still calling underweights and most investors are staying at the sidelines of the market.

In the absence of a crystal ball and in order not to miss the market bottom, it will be more profitable if we learn how to catch a falling knife. The good thing about a falling knife is that, we know it is a falling knife. So, we only need to use some precautionary measures to avoid being slashed by it. Handling something we know is definitely much easier than dealing with the unknown risks, something which hits from behind without warning. When we invest during a crisis we actually go in with our eyes open. We know it is definitely risky but we also know it could also be very profitable. If we can handle the risk, the risk-reward trade-off will be very rewarding.

Emphasis on Strategies

What we need is to buy near the bottom, not right at the bottom. Investors' frequent question now is when to buy i.e. where is the bottom? Perhaps it is more intelligent to ask how much to buy now since nobody will be able to guess where is the market bottom. Even if someone provides advice for market timing on when to buy, how can we trust he knows the answer. He is probably doing it as a favour in order not to disappoint the enquirer with a negative answer – "I don't know" (which is a fact, unfortunately), or he is probably guessing based on some assumptions.

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As long as the market is undervalued, the strategy of staggered investment ensures that investors are benefiting from that market.

Investment can be made in equal portions periodically, either by a small amount monthly or larger amount quarterly.

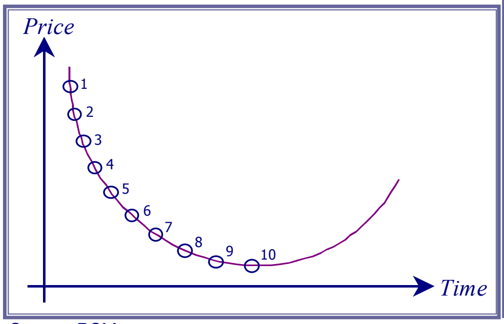
The investment portion can be modified to x percentage of cash balance, say 10% of available cash balance. An investment of RM100,000 will start off with RM10,000 in first purchase, then RM9,000 in second purchase (i.e. 10% of the RM90,000 cash balance) etc. This method will stretch the money over a longer period.

Other than equal interval investment outlay irrespective of how the market performs, timing of the next staggered investment will only be made if the market dips by say 5% or by 50 points.

For more aggressive investors, a 10-equal portion of investment could be used up before market hits the bottom (**see Chart** 1). This could happen if the market takes longer-than-expected time to recover. On the other hand, a more conservative investor may be investing too slowly and the market may have rebounded before he or she has invested half of the money set aside for investment (**see Chart 2**). This could happen if the market rebounds faster than expected.

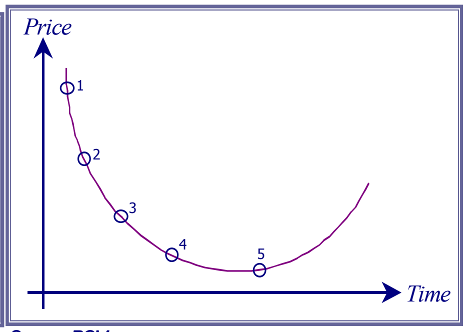
Anyway, staggered purchase is a preferred method to avoid the anxiety of market timing and the mixed feeling of fear of further downside and worry of missing the market rebound. As long as the market is undervalued, the strategy of staggered investment ensures that investors are in and are benefiting from the undervalued market.

Chart 1: Aggressive Staggered Investment



Source: PCM

Chart 2: Conservative Staggered Investment



Source: PCM

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