NEW SERIES

$how Me the MONEY

BOOK 3

Fighting Paralysis in a Market Meltdown and other Curious Facts about the Market

THE BUSINESS TIMES
SUNDAY TIMES

SMART INVESTOR | Teh Hooi Ling

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3 TALES OF FORTUNES MADE AND LOST IN RECESSIONS

Success can be one of life's worst enemies. It engenders overconfidence and, as a result, one tends to let one's guard down – in some instances, to the extent of recklessness

22 November 2008

Market crashes are the greatest redistributor of wealth. This has been true of previous crashes. But in the current turmoil, a friend noted, there are few beneficiaries. It is more a great destruction of wealth on a global scale so far.

Well, okay, some short-sellers may have profited from some of their trades. But many got wiped out in their next trade. Perhaps it is those who are not invested at all and who have the cash to pick through the carnage in the next few years who will really come out ahead. Who knows? Nobody is certain of anything anymore.

Many people have been hit hard this time around. There are a few reasons for this. One, prior to this, we've had four years of a bull market where prices had gone in only one direction. Success, notes a friend, is one of life's worst enemies. It engenders overconfidence and, as a result, one tends to let down one's guard – in some instances, to the extent of recklessness. Economist Hyman Minsky sees the cycle of risk-taking in the economy as following a pattern: stability and absence of crises encourage risk-taking, complacency, and lowered awareness of the possibility of problems.

But even for those who are conservative and have their heads centred and feet firmly planted on the ground, the economics just a few months back suggested that being invested was the right course of action. Then, inflation was running at 5 or 6 per cent and banks' interest rates were at less than one per cent.

For someone who didn't want to have his or her purchasing power eroded, keeping the money in the bank wasn't the most logical of options. Which was why many people are invested – and, worse, a lot took loans to invest. If the borrowing cost was so low, and one was expecting to make a return higher than that cost of borrowing, it made sense to borrow.

Of course, we know now that many people had underestimated or even ignored the risk of trying to earn those extra percentage points of returns.

A friend shared with me some of the horrendous stories of how an enormous amount of wealth was destroyed in the last few months.

6 HOW TO TELL A BULL FROM A BEAR MARKET RALLY

Typically, bear markets don't end in fear and panic, but on a feeling of despair and disillusionment

9 May 2009

How do we tell a bear rally from a genuine bull market? That's the question everybody wants answers to now. Well, William Hester, the senior financial analyst at Hussman Funds in the US, tries to shed some light on the topic with his article "Trading Volume Separates Bull Markets from Bear Rallies" published last month.

Most market watchers know this: to confirm a change in market conditions, watch trading volume closely. In Mr Hester's charts, the grey dates represent the beginning of bull markets since 1940 and the black dates represent the bear rallies in this decade only. (I wonder why only bear rallies in this decade were included.)

In Chart 1, the vertical axis shows the S&P 500's decline in the month prior to hitting the trough. It attempts to capture the sharpness of the final move to the low. The horizontal axis shows the bounce off the low in the following five weeks. It attempts to measure the intensity of the rally that followed.

Data that fall in the upper left portion of the graph represent periods where the market bottomed with little fanfare, and the rallies that followed were similarly uninspiring. It would characterise a market where most participants had lost interest in the market. Data that fall to the bottom right represent periods where a sharp rally off the bottom approximated the severity of the preceding decline.

But as the clump of data points on the upper left portion of the graph suggested, most of the market bottoms are not characterised by the typical V-bottom capitulations that most investors have in mind. The bulk of bear markets have ended by falling less than 10 per cent in the final month – and were followed by similarly modest moves off the bottom. The exceptions were 1987 and 1998.

Meanwhile, bear market rallies (those in black) have a more pronounced tendency to carve out an acute bottom – a capital "V" to the typical bear market bottom's lowercase "v".

The current rally sits far away from the grey data points, and shares its space with the five previous bear market rallies, said Mr Hester. Yes, market

The case for averaging down

Table 1:
Gains required to recoup losses

Loss (%)	Gains required to break even (%)
-10	11.10
-20	25
-30	42
-40	66
-50	100
-60	150
-70	233
-80	400
-90	900
-100	Permanent loss

Table 2:
Gains required to recoup losses after averaging down

Initial Investment ($)	Loss (%)	Portfolio value after loss ($)	Portfolio after injection of $5,000 new capital ($)	New portfolio value at various levels of gain ($)				
				10%	30%	50%	100%	200%
5,000	-10	4,500	9,500	**10,450**	12,350			
5,000	-20	4,000	9,000	9,900	11,700			
5,000	-30	3,500	8,500	9,350	11,050			
5,000	-40	3,000	8,000	8,800	**10,400**			
5,000	-50	2,500	7,500	8,250	**9,750**	11,250	15,000	
5,000	-60	2,000	7,000	7,700	9,100	**10,500**	14,000	
5,000	-70	1,500	6,500	7,150	8,450	**9,750**	13,000	19,500
5,000	-80	1,000	6,000	6,600	7,800	**9,000**	12,000	18,000
5,000	-90	500	5,500	6,050	7,150	8,250	**11,000**	16,500

Table 3: Selected stocks which have risen the most from their recent low

	Price yesterday ($)	Highest price in the last two years		Lowest price in the last two years		Rebound from two year trough (%)	Peak to trough decline (%)
		($)	Date	($)	Date		
Ban Joo	0.065	0.212	Jun 8'07	0.01	Dec 24'08	550	-95.3
Ezion	0.58	1.155	Jul 24'07	0.095	Oct 29'08	511	-91.8
AusGroup	0.61	2.13	Jul 27'07	0.11	Oct 23'08	455	-94.8
Medtecs	0.11	0.155	Jul 9'07	0.02	Oct 29'08	450	-87.1
Gems TV	0.08	0.82	Jun 11'07	0.015	Mar 5'09	433	-98.2
United Fiber System	0.08	0.33	Jul 9'07	0.015	Mar 11'09	433	-95.5
OSIM	0.265	0.901	Jul 9'07	0.05	Feb 27'09	430	-94.5
Jiutian Chemical Gp.	0.145	0.77	Oct 1'07	0.03	Mar 3'09	383	-96.1
Yongnam Holdings	0.23	0.555	Jul 11'07	0.05	Oct 29'08	360	-91.0
C&G Industrial	0.205	0.74	Oct 1'07	0.045	Nov 17'08	356	-93.9
HTL Intl	0.295	0.95	Jun 22'07	0.065	Nov 25'08	354	-93.2
Reyphon Agriceutical	0.045	0.61	Aug 1'07	0.01	Oct 21'08	350	-98.4
AEM Holdings	0.045	0.235	Jun 15'07	0.01	Nov 11'08	350	-95.7
Manufacturing Intg Tech	0.155	0.295	Jul 17'07	0.035	Mar 19'09	343	-88.1
Yanlord Land Group	2.18	4.22	Oct 1'07	0.5	Nov 25'08	336	-88.2
Ace Achieve Infocom	0.065	0.24	Jun 22'07	0.015	Oct 29'08	333	-93.8
Swiber	1.05	3.8	Oct 15'07	0.255	Mar 11'09	312	-93.3
SC Global	1.19	3.375	Jun 25'07	0.295	Mar 11'09	303	-91.3
Ezra	1.32	3.74	Nov 13'07	0.33	Oct 29'08	300	-91.2
Abterra	0.06	0.145	Jan 2'08	0.015	Jan 16'09	300	-89.7

Compiled by BT, Thomson Datastream

18 INVESTORS, COMPANIES LACK COMMON SENSE

They tend to go on a shopping spree when prices are high, and they top up their purchase prices with bigger premiums than in less exuberant times

13 September 2008

Compared with August last year, companies listed on the Singapore Exchange are on average 43 per cent cheaper. The median fall in price is 47 per cent. If the stock market is a supermarket and things in the supermarket are going at half price, I bet the supermarket will be jam-packed with shoppers.

Alas, this is the stock market and it has a certain kind of perverse logic to it. There'll be buyers galore when things are expensive. But when things are dirt cheap, nobody is interested.

Perhaps you think these are the actions of foolish retail investors who don't know any better. Well, even companies behave in the same way. They tend to go on a shopping spree when prices are high. In addition to the already high prices, they top up their purchase prices with bigger premiums than in less exuberant times.

See the accompanying charts for evidence. As the dotcom bubble was growing in 1999 and early 2000, global mergers and acquisitions (M&A) deals increased steadily. Then the bubble burst, followed by the terrorist attacks in the US, the outbreak of Severe Acute Respiratory Syndrome or SARS and then the Iraq War. Asset prices globally languished, and so did M&A deals.

That is until the market rebounded in 2004. The three subsequent years of bull market were accompanied by ever-growing numbers and value of M&As. Last year, globally 32,874 M&A deals worth a whopping US$4 trillion were in the works. That's up 15 per cent and 14 per cent respectively from 2006.

But since the sub-prime crisis in the US erupted, deal flow has also dried up significantly. So far this year, total M&A deals announced numbered 19,640, worth US$2.1 trillion. The first eight months showed that the number of deals has fallen by 16 per cent, while the total value has shrunk by an even sharper 34 per cent compared with the same period last year.

Obviously, financial assets such as stocks and shares are different from supermarket goods. They don't have any practical immediate use and people only buy them when they have spare cash. This largely explains why there are more buyers when it is a bull market. Everybody is rich! And vice versa.

Similarly for companies. In addition, companies have the option of using their shares as a currency; that is paying for their acquisitions with their shares in a bull market.