

TIMELESS INVESTING PRINCIPLES

Penny dispenses tried and tested classic investing advice



With the recent sharp downturn in the stock markets, some investors have started to question the wisdom of “Buy and Hold” and the merits of long-term investing. Some would even doubt that stock markets will ever recover! It is not at all that surprising investors should feel despondent when stock prices have come down sharply and news on the economic front just seem to get worst each day.

As we take stock of our current financial positions, it pays to remind ourselves of some of the important investing principles that would serve us well in navigating through these turbulent times and assist us in achieving our long term financial objectives. These principles have been tested through the various down periods in the stock markets over the last eighty years.

ADOPT SUITABLE ASSET ALLOCATION AND APPROPRIATE RISK PROFILE

An investor needs to be aware that asset allocation is the most important contributor to a portfolio’s overall performance. According to Ibbotson Associates, more than 90% of a portfolio’s overall performance is attributable to its asset allocation. Asset allocation refers to one’s portfolio weighting into the various asset classes, namely Equities, Fixed Income, Real Estate and Alternative Investments which includes the likes of hedge funds, private equity and art investments. As each asset class has its own risk-reward trade-off characteristic and behaves quite differently in each economic cycle, the weighting in each will determine the expected return of your portfolio.

Several components need to be clearly understood when you make a decision on your asset allocation; your investment objective, risk tolerance and investment horizon. For example, if you have a low risk tolerance, you need to be realistic with your expectation for investment return and your portfolio should have a higher weighting into Fixed Income which is far less riskier than Equities. Your investment horizon will determine how long you can set aside this capital for investment without

having to withdraw. The longer your investment horizon the higher your ability to tolerate volatility and to hold a greater proportion of riskier assets in your portfolio.

Invest in accordance with your investment objective and risk tolerance; you should be able to stay the course throughout difficult times when markets move against you temporarily and be able to position your portfolio in anticipation of a recovery.

AVOID MAKING INVESTMENT DECISION BASED ON YOUR EMOTIONS

To invest profitably, an investor at times needs to act counter intuitively, which means going against one’s fear when uncertainty is at its greatest. Investing in assets that are priced attractively could yield potentially lucrative returns once confidence returns and markets recover. However, this kind of behavior is usually at odds with human psychology, as many investors tend to eschew fear and adopt a herd mentality.

Stock markets in the short term are frequently a reflection of the emotions of the participants whose actions are driven not by fundamentals, but by FEAR and GREED. Hence, long-term investors who have done their proper asset allocation and adopted appropriate risk profiles should avoid making investment decisions based on emotions. This is because irrational behavior could compromise your long-term investment objective and can be detrimental to your portfolio’s return.

“Individuals who cannot master their emotions are ill-suited to profit from the investment process”

This can be surmised by quoting **Benjamin Graham**, an excellent investment manager and educator as well as the teacher of Warren Buffett. He also said that “Mr Market” can be often wrong though the truth is stock prices will fluctuate substantially in value. His philosophy was that volatility offers smart investors ***“an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal.”***

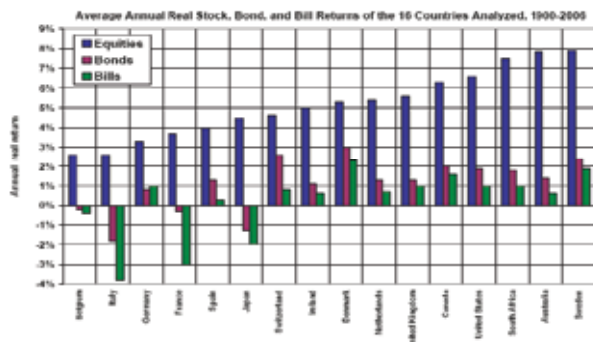
MAKE TIME YOUR BEST FRIEND

Legendary investor **Warren Buffett** believes that ***“If, when making a stock investment, you’re not considering holding it at least ten years, don’t waste more than ten minutes considering it.”***

No one is able to control which way the market will move today or tomorrow but one could make “TIME” his or her best friend. You could do so by starting your wealth-building plan early, ensuring that the money you are investing now is meant to be invested for the long term and invest regularly. Importantly, patience is needed to watch your investments grow over time, as history has shown that over the longer run the market has always produced positive return. The longer the holding period for your investment, the higher the certainty of positive return and the less risky the market becomes.

Exhibit 1 below shows that the real annual return (net of inflation) for Equities far exceeds those of Bonds and Bills for the 16 countries over the period 1900 to 2006.

Exhibit 1



Source: Stocks For The Long Run, Jeremy Siegel

INVEST REGULARLY AND TAKE ADVANTAGE OF EVERY DOWN TURN

As you build your wealth over time, you should plan to invest regularly. In particular, you should understand that the best returns are made in a bear market and learn to take advantage of such opportunity to add to your portfolio.

Peter Lynch, an successful investment manager who managed to beat the S&P 500 index benchmark in 11 of 13 years from 1977 to 1990, commented ***“I’ve found that when the market’s going down and***

you buy funds wisely, at some point in the future you will be happy. You won’t get there by reading ‘Now is the time to buy.’”

TRY TO AVOID TIMING THE MARKET

Investors try to “time” the market by getting out of stocks when market corrects and attempting to move back in when stocks become favorable again. However, history has shown that timing the market can be a futile exercise. This is because you may miss the worst days in the market but similarly you may also miss the best days too. Investors should recognize that no one can predict when the market will bottom and peak. In fact, what could be worst is when investors decide to sell only after the market had declined i.e. realizing their losses and then to later miss out of the sharp rebound which could be the best days when the market recovers.

To illustrate how missing the best days in the stock market could impact negatively on an investor’s investment returns, Exhibit 2 illustrates the returns of a portfolio from end of 2002 to 2007. It shows that an investor who missed the 10 best days will suffer a negative impact of 26.23% to his portfolio comparing to one who stayed invested throughout. For an investor who missed the 40 best days, the negative impact is as high as a 93% difference!

Exhibit 2: Investment of \$10,000 from 31 December 2002 to 31 December 2007

Missing the best days in global Shares	Fully Invested	With Market Timing	Difference	Difference %
10 Days	\$18,607	\$14,741	\$3,866	26.23%
20 Days	\$18,607	\$12,561	\$6,046	48.13%
30 Days	\$18,607	\$10,932	\$7,675	70.21%
40 Days	\$18,607	\$9,638	\$8,969	93.06%

Source: Date is courtesy of FIL Investment Management (Singapore) Limited

MARKETS GO THROUGH CRISIS AND SURVIVE

Historically, markets have survived through many crises and continued to grow over time. Investors who have adopted the right mindset to accept that markets do move up and down at various times, are better prepared to weather bad times when markets are down temporarily, less likely to make knee-jerk reactions and drastic changes to

their investment plans that could derail their long-term objectives.

In addition, the longer you are able to hold your investments, the less volatile your investment returns will be. This can be seen in Exhibit 3 below. Please note that the highest and lowest returns for a 10-year investment are 19.6% and 2.1% respectively, which is a difference of 17.5%. However, over a shorter period of 2-year, the returns are 51.7% (highest) and -27.3% (lowest) which is a great divergence of 79%!

Exhibit 3: Volatility of returns drops as the investment time horizon gets longer

Investments held for any	Highest Return p.a.	Period	Lowest Return p.a.	Period
10 Years	19.6%	Aug 1977 to Aug 1987	2.1%	Jul 1972 to Jul 1982
7 Years	25.7%	Jul 1982 to Jul 1989	0.5%	Dec 1972 to Dec 1979
5 Years	34.4%	Jul 1982 to Jul 1987	-6.7%	Dec 1969 to Dec 1974
2 Years	51.7%	Apr 1985 to Apr 1987	-27.3%	Dec 1972 to Dec 1974

Source: Data is courtesy of FIL Investment Management (Singapore) Limited

Acknowledge your inability to predict the future. ***“In this business if you’re good, you’re right six times out of ten. You’re never going to be right nine times out of ten.”*** as commented by Peter Lynch. He added ***“Look at market fluctuations as your friend rather than your enemy. Profit from folly rather than participate in it.”***

AVOID INVESTING IN PRODUCTS THAT YOU DON’T UNDERSTAND

Investors who understand what they are invested in are less likely to panic during market turmoil. Greater knowledge gives investors the confidence that their investments will be able to survive the harsh economic environment and will ultimately benefit when the market recovers.

One should not invest in products that he or she cannot understand. When a product sounds too complicated and the potential risk cannot be fully comprehended, it is best to walk away from it, rather than be saddled with a nasty surprise. Recent nasty surprises such as the failure of Minibonds, Pinnacle notes and many complicated structured products could have been avoided if investors had read the investment documentation or asked further questions.