

Negative mood creates buying opportunity

by Charles de Kock

Buying high-quality assets at low prices is the route to wealth creation. It is April 2008 and investors are nervous. And rightly so. The world is awash with bad news.

The financial/liquidity crisis

The global financial system is under threat due to the injudicious lending practices of greedy bankers exposed when the property bubble finally popped. As a result, banks are being forced to write off billions of dollars in bad debts. Many once big and powerful firms such as UBS and Citigroup, to name but two, face the task of rebuilding their balance sheets while Bear Stearns has had to suffer the ultimate price of being taken over by JP Morgan to save it from bankruptcy. Liquidity has dried up resulting in very few new loans being granted. As a consequence, economic activity is slowing down.

Recession fears in the US and slowdown in Europe and Japan The slowdown in lending and loss of confidence in the US is propelling the world's leading economy towards recession. In Europe and Japan the 'R' word is not yet in use, but both regions are also facing at least a slowdown in economic growth.

Inflation on the march

Surging energy and food prices is a global phenomenon which is causing sharply higher inflation in many countries across the globe. Central bankers are presented with the dilemma of fighting inflation in the face of slowing economic growth. An unenviable task as the tightening of monetary policy to curb inflation will further depress economic growth and jobs.

Domestic concerns around politics and the Eskom debacle

Already rattled by global concerns, the ANC conference at Polokwane and the power outages caused by Eskom's poor planning and execution of its duties have greatly impacted the JSE.

Investors are human and cannot help but be influenced by the news of the day. The abundance of bad news has therefore resulted in many investors liquidating positions.

In South Africa we have seen huge selling of equities by foreigners in the first quarter of 2008. The rand has consequently depreciated sharply as the money has flown to 'safer' harbours.

The JSE

On the JSE the weak rand and strong commodity prices have supported the resource shares. The prices of most commodities have been very firm despite the negative news on the global economy. We are of the view that the pending economic slowdown in global growth will also in due course exercise downward pressure on these prices. Commodities have always been, and remain, cyclical in nature. The combination of a slowdown in demand and an increase in supply as new production is brought on stream to capitalise on the extraordinary potential profits will inevitably lead to lower prices.

Domestic financial and industrial shares have been sold off aggressively, with prices now reflecting the negative sentiment echoed globally. In many cases we believe the share prices are so low as to offer the long-term investor an excellent buying opportunity. If one looks back in history there have been several episodes of despair among investors that have led to excellent buying opportunities. The current pricing of many domestic companies is again giving us an opportunity to acquire high-quality businesses at very attractive levels.

Shares such as the big four banks, Tiger Brands, AVI, Woolworths, Truworths, Mr Price, Bidvest and many other large caps, as well as a whole array of smaller cap shares, are trading on PEs below 10 and in some cases as low as around 6 times earnings on a one-year forward basis.

Dividend yields in most of these examples are also in the 4% to 6% range. We find these valuations quite compelling and urge investors not to let their emotions dictate decision-making, but to stick to the proven principles of long-term investing. Buying high-quality assets at low prices is the route to wealth creation. The pervasive negative sentiment of the day has given us this opportunity. Use it.

Charles de Kock

Charles plays a leadership role in the asset allocation process and is responsible for the management of a number of balanced retirement funds as well as the core benchmark conscious equity portfolios. He also co-manages the Coronation Balanced Defensive unit trust fund.