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THE WEEKENDER
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Reading between the lines to find value

ARE WE in a bear market rally? I hope not. Historically, bear market rallies really damage the investor psyche, chasing real money away from equities.

Secular bull markets are great places to be as a long-term investor. All one has to do is buy and hold, and buy some more on the dips. That is why investors get carried out in the bear that follows — a buy and hold strategy compounds losses, and buying the dips ensures that biggest transgression in investment: losing capital.

All the great investors out there know one simple, absolute truth: preserving capital is paramount to investment success. Making fewer mistakes — that is, taking fewer losses — is as important as finding the next bargain, if not more so.

Compounding works only if you have capital. Constantly taking losses on your capital hampers the magic of compounding. What concerns many investors is when they should invest and how they should time their entry. The maths says that if we invest at the peak and have to endure a ravaging by the bear, we are going to end up fighting to get back to square one for a long time.

Investment decisions are based on a wealth of information — an entire industry is dedicated to feeding us the latest story.

Our challenge is to find value in the information flow. We need to be able to decipher whether Iran's nuclear ambitions are relevant to us, whether Cosatu's latest stance on the MTN deal is important or whether the liquidity that the world's central bankers have provided will have an effect on our investment universe.

Searching for the second derivative is hardly the exciting stuff of buying the dips, but it is what truly great investors do: looking at the circumstances, seeing the probable effects, and investing in companies and assets that will benefit from those effects.

In the Californian gold rush, for example, the derivative is not the miners, the prospectors, the owners; it is the providers of shovels, wheelbarrows, liquor and entertainment. In other words, the derivative of the gold rush is where we should have been investing.

Current valuations suggest a rosy picture for the future. Asset prices have started to recover, helped along by the liquidity that has been pushed into the market.

Whether this appreciation of asset prices is backed by economic realities, or simply driven by liquidity, is of course the investor's first decision.

The second decision is whether there are any long-term effects to the liquidity that has been provided. Many market professionals have commented that there must be a second-round effect to simply printing money.

One widely held concern is whether the dollar exchange rate can be sustained. A theme in the recent dollar weakness was commodity strength, but even that relationship seems to be under strain. So where

do we go with valuations looking to a bright new day, liquidity on tap that can be recalled at a moment's notice, and commodity prices that seem to have run out of steam?

Calling a bear market rally with all the liquidity sloshing around is difficult, but the probability is that there will be unforeseen consequences that will cloud the future.

So bear or not, look for real value and do not try to time this market but know that the cycles will possibly help the astute investor avoid the same mistakes of those who have gone before.

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