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Merits of short vs long-term investment positions

FocusM **spoke to fund managers, asking their views on the virtues of short vs long-term investment under uncertain market conditions. They all agreed that investors should not dance to the tune of the market.**

by Dinesh Immanuel

THE vagaries of the current market conditions present quite a challenge for investors seeking to derive good returns in the equity market. After a five-year bull run, is the benchmark FBM KLCI showing signs of fatigue? The KLCI has spent a good part of this year trading range-bound. However, on May 15, the index hit an all-time high of 1,879.83, signalling that a change in direction is imminent. Of course, whether a bull or bear market is in the offing remains to be seen.

As at May 15, the KLCI has only gained 12.87 points or 0.69% against its close on Dec 31. At the same time, with the FBM Small Cap index seeing gains, investors shifted their attention to mid- and small-cap counters. The index also increased its volatility.

On the other hand, improving economic conditions and Malaysia's trade position will positively impact investor sentiment in the second half of this year, resulting in stronger performance in the country's stock market. Latest data indicate that real exports have grown by 3.3% year-on-year (yoy) in the first quarter of this year, following an increase of 2.9% in the last quarter of last year, attributed to recovery in global demand for Malaysian exports.

With the high volatility of the indices, a key question that frequently crops up is how investors should allocate their money under such conditions. Should investors take a short term or long-term position is a matter of debate among various groups of investors.

"That's a very tough question to answer," says Alex Lu, a remisier with a local stockbroking firm. "It would be wiser now for investors to be selective and careful in this market, rather than invest with a wait-and-see attitude which may not always guarantee future returns."

Generally market conditions will always make it challenging for investors to find attractive counters to hold, hoping for future upside. Taking a trading stance (ie short-term holding) is generally regarded as wiser in a highly volatile and uncertain market. This is especially true when trading in mid to small-cap stocks.

Maybank Asset Management Sdn Bhd (Maybank AM) CEO Badrul Hisyam Abu Bakar says short-term position is a better strategy at the moment. "We do acknowledge that markets are volatile, and hence in the short term it is necessary for active management of positions," he says. However, he advocates a good balance in managing short term and long-term portfolio positions.

On the other hand, Aberdeen Asset Management Malaysia's (AAM) CEO Gerald Ambrose takes into consideration the fundamentals of a company's performance. "The decision to invest depends on a company's value. It must be a company [counter] which in our view offers an attractive upside to its fair value," he says.

Badrul says short-term position is a better strategy at the moment

What about the improving (or slowdown of the) economy?

While both short and long-term investment positions have their challenges and benefits, signs of improving economic conditions and a strengthening of Malaysia's growth catalysts will likely see equity markets gain firmer footing moving into the second half of this year.

In an Economic Update report on May 15, RHB Research Institute notes: "Real GDP is estimated to have grown at a faster pace of 5.2% yoy in Q1, after rising to 5.1% recorded in the Q4 of last year.

"This was attributed to a recovery in exports [which recorded] the third successive quarter of growth on account of stronger demand from advanced economies. A resilient domestic demand also provided support to economic growth during the quarter."

Despite inflationary pressures and a general feel of a higher cost of living, the report notes that domestic demand remains resilient and will be a key support to economic growth.

"A resilient domestic demand, alongside recovery in exports, will likely lift the country's real GDP growth to 5.4% in 2014, faster than 4.7% in 2013," states the report.

A pick-up in domestic demand and exports will benefit local Bursa-listed trading, manufacturing, and local infrastructure and construction companies as noted by Badrul Hisyam.

Below is an excerpt from the views put forward by both Gerald Ambrose and Badrul Hisham.

What are the pros and cons of short term vs long-term investment positions under current market conditions?

Badrul Hisyam: At Maybank AM, we are positive on the long-term prospects of the Malaysian economy and the domestic equity markets. We believe that in the long term, the intrinsic value of fundamentally-sound companies will be reflected in stock prices.

Hence, our investment philosophy is to have a long-term focus when we invest. However, we do acknowledge that markets are volatile. Hence, in the short term, it is necessary for active management of positions in order to generate (higher) alpha and to manage risks. Under current market conditions, with the KLCI close to an all-time high and lacking near-term catalysts, we expect that the market will be range-bound with modest upside, supported by ample liquidity.

However, over the long term, we continue to like sectors that will benefit the most from the government's Economic Transformation Programme (ETP), including oil & gas and construction.

For fixed income securities, the risk for yields is on the upside as rates normalise over the medium to long term. However, we expect that yields for benchmark government securities remain anchored in the near term on the back of ongoing uncertainties, including uneven global growth recovery, geopolitical tensions in Ukraine and, to some extent, Thailand as well as the pace of interest rate hikes domestically and in the US.

Overall, a balanced approach between long-term and short-term investing is necessary to generate positive, sustainable risk adjusted returns.

Gerald Ambrose: The Aberdeen Asset Management group uses the same investment process globally. The process looks firstly at companies' quality before looking at their valuations.

Our quality criteria (amongst others) are: Are we confident that the company's business model can grow profits over the long term in 8-10 years? During the period, will the company be able to generate the cash flow to fund that growth without excessively resorting to borrowings? Will we have sufficient free cash flow to pay out dividend?

Do we trust the management? Are they enthused by their business or are they going to stick to the business where we recognise they have strengths and competitive advantage? Does the management recognise the rights of minority shareholders? Is the management transparent?

Only after the team has agreed on these criteria (inter alia) might we consider investing in a company. The decision whether to invest then turns to a company's value; it must be a company which, in our view, offers an attractive upside to its fair value.

The investment team spends most of its time preparing for, carrying out and then writing up visits to companies using our inhouse template which we hope leaves no stone unturned and which obliges each investment manager to look at a company from all angles.

The resultant portfolio of stocks after going through this process tends to be held for the long term, having qualities which ensure profitability in all economic conditions. We hope to be able to buy these stocks when the market is grossly undervaluing the company and sell them when it is grossly overvaluing them.

In this way, we tend to enter more into a long-term partnership with companies in which we invest. In a way, that is what stock exchanges were originally set up to achieve: allowing those with good businesses needing funding to meet up with those with funds looking for good businesses. FocusM