

Embracing a Bear market

Everyone remembers with smiles on their faces, the “bull run” that the market experienced from 2002 to 2005. Prices were soaring; investors were able to make stupendous gains in a short period of time. At the end of each trading day, investors waited with baited breath to see how much their stocks had appreciated. Now looking for this excitement is like trying to find water in the desert.

Don’t get me wrong, the initial downturn of the market was expected. Share prices were appreciating with alarming speed in comparison to the growth of the companies. It’s not that the listed companies were not performing; it’s that they weren’t growing at the same rate as their prices were suggesting. This situation led to higher price/earnings multiples and it was postulated that this rate of growth in share prices could not be sustained.

It therefore came as no surprise when share prices began to fall. Analysts however expected that this would have been a short term circumstance and that the last quarter of 2005 would have seen some rejuvenation in the market. However, we are well into 2006 and still searching for the end of the ‘correction’.

When a market correction turns into a bearish market

A market correction is usually characterized by a ten per cent decrease in multiple indices where as evidence of a bear market is found when multiple indices decrease by fifteen to twenty per cent. If it was that we were simply experiencing a market correction, the indices would have begun to stagnate since the middle of August last year when the Composite Index fell by 10.63 per cent from its peak while the All T&T had fallen 13.35 per cent. The Composite Index was also influenced by the Jamaican cross-listed companies that were experiencing downward pressure in the market due to the impact of negative forces in the economy resulting in part from the effects of hurricanes and rises in food prices. In addition, this uncertainty led to an outflow of US Dollars. This pressure on the economy created a situation where shares may have been undervalued but investors were skeptical about investing due to negative forces in that country.

As Figure 1 demonstrates, the indices have continued to fall and at the end of February were 18.56 per cent and 21.67 per cent lower than its peak for the Composite and All T&T Indices respectively. It stands to reason that we are indeed facing bearish market conditions.

How can we be experiencing a bearish market in the middle of an economic boom?

Though markets are usually correlated with the economy, there are other factors that influence the path of the market.

1. Institutional Investors

These players are the major contributors to the market and were once responsible for up to 80 per cent of the shares crossing the floor. The onset of 2005 however saw the

enforcement of regulatory rules on these companies especially in relation to their pension funds. These regulatory rules stipulate that a pension fund should not have more than 50 per cent of its portfolio in local equities. The problem is that a lot of the institutions were already heavily weighted in equities, much more than the stipulated amount. Hence, when the rules were enforced the institutions had no choice but to withdraw and cease buying on the market. In some cases there was initially an onslaught of shares on supply from the institutional investors. Even though prices have fallen considerably, some institutions still carry a heavy weight of equity in their portfolio. In addition, the lack of institutional investors has also brought prices down on thinly traded volumes.

2. Market Sentiment

Human emotion affects the market tremendously. Confidence in a market would see great demand for shares as investors are self-assured that they will reap positive gains in their required time. This was one of the reasons the bull run of 2002 to 2005 spawned great interests and demand in the market. The market was rising for what seemed an eternity. There was hardly any hesitation from investors when considering putting their money in the stock market. After all, the market was delivering exceptional returns.

Unfortunately, the reverse is also true. Lack of confidence in the market due to falling prices would result in low demand for shares or a heavy supply of shares also creating downward pressure on prices. Hence, when prices started to fall, investors who were 'spoiled' by the great ascent of the market lost some confidence in the market and made decisions to sell out their portfolio. In addition, the market may have overestimated the earnings growth of some companies and may have become disconcerted upon the release of results that were good but not up to expectations.

3. Interest Rates

The bull run of the market came at a time when interest rates were low and investors were looking for other avenues from which they could gain a return on their investments. Investors were encouraged to invest in the stock market as there was much more room for capital appreciation. Now, interest rates are back on the rise and investors have premised that they can gain the same return that the stock market is currently offering on more secure investments.

A benefit of falling interest rates is that money becomes cheap. That is, people were able to borrow money at low interest rates in order to invest it in the market to reap higher returns. When prices began to fall it was also the time that interest rates began to rise. Investors soon realized the double-edged sword of higher interest costs and falling share prices. They either had to prop up their margin or try and sell the shares maybe at loss.

4. Electronic Trading

Electronic trading made its debut in the T&T Market on March 18th, 2005. Before electronic trading, price movements were a lot less tempered than they are now. No computations were done by a computer; it was simply bidding and offering on the trading floor. However, the electronic system has brought the forces of demand and supply more into the price of the share much quicker than we would have seen before. Share prices

began to fluctuate more consistently with the demand and supply forces of the market which resulted in more volatility.

Looking for the bottom

The bottom of a bearish market would not only be characterized by lack of supply, but also by heavy demand. However, in order for great demand to come back onto the market a still of confidence would have to be injected into the market. Heavy demand on the market would begin to drive prices in a positive direction, hence, once advances begin to consistently outweigh declines this would be an indication that the market is headed for a rebound.

The problem with our market

Unfortunately, the Trinidad equity market has functioned somewhat as a momentum market. When prices are moving up, people join the bandwagon and when they are falling people are tempted to pull out. This was fostered somewhat by illiquidity in the market which aided in the movement of prices.

A better strategy in terms of investment is to look at the fair value of the share and discuss such topics with your investment advisor. Ensure that you understand the operations of the company and not only the avenue from which it intends to achieve its growth but also the time frame. This should prevent buying shares that are overpriced. Sometimes investors are enticed to purchase a share based on the premise that the price of the share has been rising. A share that has been on the rise however, may sometimes be nearing its peak. Wanting to invest in a share simply because it has been climbing is not a good enough reason for an investment.

Anyone for a bear hug?

Right now, some shares may have very well reached close to the bottom while others may still be over-priced. The future may not be as gloomy as it seems. There still however remains a supply of shares available on the market while the lack of institutional presence still plagues the market. Even though this is our reality, the key is to find the shares that are worth buying into at this point in time. It does not make sense to discredit the market because we all know that huge gains can be made on this market. Past articles have dealt with managing the fall of the market in great detail and also suggested possible strategies for investors who entered the market late. In terms of purchasing, those with an already existing portfolio can look to adding a share undervalued at this point in time that they may not already have and which carries some degree of stability.

A bearish market however has great appeal to new investors. Veterans of the market should encourage their younger counterparts to begin investing at this point in time. Currently, prices are low, and such investors would most likely be looking toward long term growth. This would therefore be the most opportune time for such investors to start thinking about equities especially to be held for a medium to long term horizon.

Even though a bearish market brings grim faces, one has to come to terms with the fact that investors have indeed been spoiled by the bull run of the market. Any healthy market will experience what our equity market is going through at some point in time. However, there is always room to make the best out of every situation. Now is the time for young counterparts to indulge in the market. Let's face it, investors have made considerable profit in this market and past glories can be relived. The important factor to consider is the time frame. So, as the paws of the bear are coming down on the market, don't fight it, embrace it.

Figure 1

