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Wealth
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Show me the money

Who do we listen to?

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A FEW weeks back, I tried to introduce two of my friends for a potential collaboration. One of them is Tan Teng Boo, founder of independent fund manager Capital Dynamics.

CONFUSING
Some strategists say that a meltdown occurs when the unexpected happens and panic engulfs investors

The meeting was fixed on the first week of August. I was supposed to join them but thought I'd be a hindrance rather than a help by being there. So I dropped Mr Tan an e-mail on July 29. The mail said: Teng Boo, You guys go ahead and meet up. I don't think I need to be there lah... catch you another time. Hope everything's fine at your end. Cheers, Hooi Ling

The response came back three minutes later. It said: Hooi Ling All our funds are ready for a meltdown. 2011 is the year to be ready for the unexpected. Best wishes. Teng Boo

So I asked: 'Meltdown because of what?'

'The unexpected,'came the reply.

'Meltdown only happens when there is overvaluation, right? We are not in over-valued territories what?'

'Meltdown happens when the unexpected happens and panic engulfs investors.'

The above exchanges took place between 4.39 pm and 5.12 pm on Friday, July 29.

The following week, as we all know, was the deadline for the US lawmakers to raise the debt ceiling, failing which the US government would run out of money to meet its obligations.

A deal was struck over that weekend. The market heaved a sigh of relief and there was muted cheers on Monday. Then market players started to refocus their attention on the real economy and they didn't like what they were seeing. The long-term fiscal health of the US is also a great concern, and there didn't seem to be any political leadership and willpower to come up with any viable solution. Meanwhile, the European debt crisis continued to fester.

So on Thursday, traders and investors in the US woke up in the morning and decided to get out of risky assets en masse. That triggered a global sell-off and trillions were wiped out of stock prices around the world. In Singapore, the Straits Times Index shed 10 per cent in five trading sessions to Thursday. Yesterday's rebound trimmed the losses to 8.3 per cent.

Mr Tan said his firm's iCapital International Value Fund held 50 to 55 per cent cash going into the recent crash. That's higher than the 34 per cent level in the 2008 global financial crisis.

In his Aug 5 newsletter, Mr Tan noted that when he was interviewed by The Economic Times of India in February this year, he said he would be happy if he can end 2011 not losing money.

After that, he has been screaming whenever he can and to whoever wants to listen to him, a bear, a bear, a bear is coming. Few believed him, some laughed at his bearishness. Just like in early 2009, when he screamed that a V-shaped recovery, a new bull market was on the way. Few believed him then, and some called him a forever bull.

Well, Mr Tan wasn't the only one who sounded the horn of caution. I spoke to Jeremy Grantham when he was here in May. The year to Sept 30 is the

third year of the US presidential cycle. US equities typically chalk up good gains, to the tune of 20 per cent, in the third year. By May, the S&P 500 had risen by some 17 per cent compared with Oct 1 last year. 'There are three months left, and too many things are going wrong. It's time to cut back any extra risk and wait till Oct 1,' he said then.

Near the cliff

He also noted that another possible signal that we might be near the cliff was that the blue chips stocks had been outperforming the small caps and junkie stocks. 'I've highlighted this phenomenon that very late in a bull market, blue chips often start to outperform. The reason, I think, is people don't want to go off the cliff in a junkie company.'

Against the calls for caution are others who continued to beat the drum of bullishness. On July 27, for example, JP Morgan Asset Management released its second semi-annual investor confidence index. The index had dipped compared to late last year. The investor confidence may be affected by recent global events and less-than-robust economic numbers, said the firm's head of investment services in Hong Kong. But he advised investors not to 'cut and run' from the markets now. 'If you do, I think you'd probably live to regret it.'

HSBC's global head of equity strategy meanwhile, did warn that the first week of August was going to be 'very hairy' for investors, and that there was a high chance that the US credit rating would get downgraded.

'This is the last big risk hanging there for the market,' he said, 'but once we've gone past this, it's actually a pretty nice time to buy equities.'

With so many varied views out there, how do we investors know who we should pay more attention to?

Well, humans are by nature optimistic. When two views are presented - the optimistic and pessimistic ones - we tend to think that the optimistic view will pan out.

That is until we are proven so dead wrong that we lose hope entirely and regard any light at the end of the tunnel as an oncoming train. That's the time we would dismiss any optimistic prognosis.

Seth Klarman, one of the leading value investors today, said the only way for investors to significantly outperform is to 'periodically stand far apart from the crowd, something few are willing or able to do'.

Mr Grantham and Mr Tan are the few who have the intellect and courage to periodically stand far apart from the crowd. In Mr Grantham's words, most fund managers and analysts tend to flock together for fear of career risks. Better be wrong with the crowd than be wrong alone.

So I suppose, in the increasingly confusing world that we live in, we should give more weight to views by investors who have shown independence of thought, those who see beyond the short-term and who have a sound understanding of the intricacies of the various parts of the economy. All of these characteristics would have shown up in their good long track records.

Alas, most of these investors are still not bullish yet. They have yet to see any real solutions to the problems plaguing the world's economy.

Said Mr Klarman in a recent letter to investors: 'Most of us learned about the Great Depression from our parents or grandparents who developed a 'Depressionmentality', by which for decades people shunned leverage, embraced thrift, and thought twice before quitting their secure jobs to join risky ventures.

By bailing out the economy rather than allowing the pain of the economic and market collapses to be felt, the government has endowed our generation with a 'really-bad-couple-of-weeks-mentality': no lasting lessons are learned; the government endlessly intervenes in the economy, and, ironically, the first thing to strongly rebound from the 2008 collapse isn't jobs or economic activity but speculation.

Room for error

'Benjamin Graham's margin-of-safety concept - to invest at a sufficient discount so that even bad luck or the vicissitudes of the business cycle won't derail an investment - is applicable to the economy as a whole. Bridges intended for 10-tonne trucks are overbuilt by engineers to hold vehicles of 30 tonnes.

Responsible investors assume their best judgments will sometimes go awry and insist on bargain purchases that allow room for error. Likewise, an economy built with no margin of safety will eventually implode.

Governments that run huge deficits, promise entitlements that will be next-to-impossible to deliver, and depend on the beneficence of foreigners to stay afloat inevitably must collapse - perhaps not imminently but eventually, as Greece and Ireland have recently discovered.

'It is clear, both in the financial markets and in government policy, that no long-term lessons have been drawn from the events of 2008. A friend recently posited that adversity is valuable not for what it teaches but for what it reveals. The current episode of financial adversity reveals some unpleasant truths about the character and will of our country and its leaders, and offers an unpleasant picture of the future that awaits, unless we quickly find a way to change course.'

Howard Marks, chairman of Oaktree said in his latest letter to clients: 'For the last several years . . . I've described the typical American as follows (exaggerating for effect, of course): He has US$1,000 in the bank, owes US$10,000 on his credit card, makes US$20,000 a year after tax, and spends US$22,000. And what do lenders do about this? They mail him additional credit cards.

'In much the same way, credit has been available to governments deemed creditworthy without limit and without concern for the fact that:

'Countries were constantly spending more than they were taking in. Their deficits were growing non-stop relative to GDP. Their national debts likewise were expanding relative to GDP. In other words, repayment of principal was absolutely unimaginable.

'One of the most striking aspects of debt in the modern era is that little if any attention is paid to repayment of principal. No one pays off their debt. They merely roll it over . . . and add to it.

'It seems apparent that in recent decades, politics has become more partisan, and solving the nation's problems has taken a back seat to adhering to ideology and getting re-elected. And what gets people elected? Promises of more: more benefits without increased taxation, and more take-home pay without reduced largesse.'

Indeed there is a lot to fix, and in times like this, we have to appreciate the importance of having a strong, rational leader who can push through solutions for the long-term good of the country, and by extension, the world, given how integrated we are today.

- **The writer is a CFA charterholder**

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