

SHAREMARKET STRATEGIES

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Why invest in shares?

Today many people take a lively interest in saving and investing their money. Greater wealth means greater freedom of choice and more security for the future. Any investment decision is a trade-off between risk and return. Where the return is high, the risk is bound to be high and where the risk is low, the return is bound to be low. The psychology of the investor plays an important role in the matter of deciding on a particular type of investment. If an investor is extremely cautious he may go in for savings schemes like fixed deposits. On the contrary if an investor is enterprising, adventurous and willing to take calculated risks, he may select shares.

Something that is quizzing every mind is the daily movement in the price of a variety of shares. Sometimes people ask the obvious question. "How is it that in one day the price of Ceylon Oxygen Ltd or the price of Pure Beverages Co. Ltd vary by Rs. 5/=. Have these companies increased their assets overnight? Even when prices decline, some wonder as to what could have happened to those companies just within one or two days. Price changes at the sharemarket largely represent the demand for and the supply of a particular share and to some extent the general mood, rather than the intrinsic worth of companies.

Market Risk

Share investment risk is normally viewed as having three components: market risk, industry risk and company risk. Market or systematic risk is a result of economic factors that effect all shares (widespread effect); interest rate changes, inflationary expectations, investment flows, regulation and taxation.

Industry Risk

Industry risk, which applies to all participants in a particular industry, emanates from factors such as concentration and international competitiveness. A company may be financially sound, but investors sentiment towards its industry group may influence the variability of its price. The relative impact of

such influence tends to be less than that of market forces.

Company Risk

Company or specific risk results from economic factors influencing a particular business that cannot be attributed to macro-economic or industry forces. The ability to maintain quality, and to develop viable new products and markets, are examples of such investment risks. Estimate of earnings by stockmarket analysts and the expectations they create also contribute to specific risk.

Investment Strategy & Market Exposure

The main features of a safe investment strategy are the reduction of risk and the maintenance of a diversified portfolio to enhance market rewards during bullish times. This would mean that such a portfolio should exhibit less volatility. Therefore an effective strategy for investment would encompass the following:

- (a) Want to supplement the dividend income with capital gains, bonus issues and rights.
- (b) Want to reduce the risk of a portfolio.
- (c) Are willing to exchange risk for future reward.

The initial allocation is usually based on criteria reflecting the nature and duration of the investment with which the shares are matched. Subsequent movements, or expected moves, in the valuation of the separate stock groups require shifts in their allocation. While the long-term goal for individuals and others might be to exceed the returns historically associated with the sharemarket, investors normally will avoid shares based upon unfavourable market expectations.

Depending upon the individuals overall investment objectives strategies may be stipulated as follows:

- (i) Long term capital gains—some investors are more interested in capital gains in the long-term, rather

than current income. A person who earns a sufficient amount to meet his current needs, or a person whose tax bracket is high may not be interested in additional current income. Such individuals may prefer to have capital growth over the long term. Growth shares such as Lanka Tiles Ltd, Merchant Bank of Sri Lanka Ltd, Development Finance Corporation of Ceylon Ltd are examples in this sector.

- (ii) Short term profits—some investors who are willing to take risks and speculate, may be more interested in quick shortterm profits. They may deal in cyclical and as well as speculative shares (example would be Lanken Ceylon Ltd, Samuel Sons & Co. Ltd and so on).
- (iii) Current Income—there are some investors who need a stable current income. For a defensive strategy such as this where one invests in shares with less violent moves the shares chosen would comprise those with high dividend yields.

$$\text{dividend yield} = \frac{\text{Dividend per Share}}{\text{Market price of Share}}$$

- (iv) Bargain hunting—there are some investors who pick up the underpriced shares. These are the neglected shares in the sharemarket. They are available at a price less than their net asset value.

$$\text{Net asset Value} = \frac{\text{Capital} + \text{Reserves}}{\text{Number of Shares}}$$

Some important market guidelines to watch

1. An improvement in turnover at the Colombo Stock Exchange in terms of value of shares transacted.
2. Higher company profits and a consistent earnings trend.
3. Stock Market indices—the CSE All Share Price Index, Sensitive Price Index and Sectoral indices also exhibit a clear guide when investing.
4. The number of stocks registering price increases in contrast to those registering price declines.
5. Rumours and news.
6. The price to earnings ratio (PER) for stocks.

$$\text{PER} = \frac{\text{Market Price of Shares}}{\text{Earnings per Share.}}$$