



Value Investing

Would you invest in times such as these when the US and other international stock markets are reaching multi-year lows and reference is being made to “a global financial crisis” and “market meltdowns”? Should you? Share prices have been trending downward (both locally and internationally) and even the novice investor knows at least this – “buy the share when the price is lower and sell it when the price is higher to make a profit”. While buying low and selling high “makes sense” it also seems intuitively odd to purchase something when its price (often mistaken for its value) is falling. Therein lies the challenge. How do you distinguish a good opportunity from a dive into the deep end or “catching a falling knife”? The answer – invest for value.

When one gets into equity investing, it is tempting to run after the “winners” whose share prices are increasing while the “losers” with falling prices are not given much thought. However, knowledge of the intrinsic value of a stock (using fundamental analysis) is an important consideration. The output of fundamental analysis is a value (price) which the investor can compare to market prices to determine if a stock is under-valued or over-valued. The aim would be to buy under-valued stocks, that is, stocks which are currently going for a price lower than their calculated worth. The assumption is that eventually, the market will pay for the stock what it is actually worth. So, if you get carried away by market euphoria you may buy too high and have a difficult time selling at a gain. On the other hand, if the price is falling, you can decide on an entry price that would get you a return when the price of the share rebounds to reflect the share's intrinsic value.

There are various methods available for valuing a stock, for example the dividend discount model which is a type of discounted cash flow analysis. Discounted cash flow analysis is used to determine a stock's value based on estimated future cash flows. Valuation ratios are also used such as the price-to-earnings (P/E) ratio and the price-to-book (P/B) ratio which compare the market price of the stock to earnings per share and book value respectively. Use of these ratios is most effective when a comparison is made to the company's past performance and the performance of industry peers. It should be noted as well that the reliability of these ratios is dependent on the reliability of information presented in a company's financial statements.

A challenge that presents itself is that no one method is “correct”. This means that two individuals analyzing the same information could come up with different valuations. One way to maximize the possibility of arriving at an accurate valuation is to use different methods and determine an average intrinsic value / fair price. In addition, you can purchase shares with a “margin of safety”, that is buy at an even lower price to limit the impact of an incorrect estimation.

There are external factors that could impact on a company's performance and by extension its share price that must be considered as well. The overall health of the economy must be taken into account, for example a downturn may negatively

impact a company that sells discretionary consumer goods such as jewelry, electronics or trendy clothing. Attention should be paid to the industry in which the company is operating – are there new regulations that might impact costs? Or are there new competitors that may take away market share? In addition to the quantitative analysis of the company (using the valuation methods mentioned above), one must also consider qualitative factors such as the skill and expertise of the management and whether the company has a special competitive advantage.

While this sort of analysis may seem a bit daunting, the good news is that information is bountiful, for example, from your investment broker and even via the internet. With regard to companies trading on the Trinidad and Tobago Stock Exchange, there are a few examples of shares that are currently trading below their fair value (as at 25 September 2008) and which therefore present buying opportunities. Based on CMMB's analysis, these include Sagicor Financial Corporation (SFC) with a one-year valuation of TT\$25.56, Neal and Massy Holdings Limited (NML) with a one-year valuation of TT\$68.89, and Guardian Holdings Limited (GHL) with a one-year valuation of TT\$37.40.

What should be remembered is that while in the short-term share prices experience swings in both directions, in the long-term share prices generally trend upward. Once you choose to invest in companies that have strong prospects for future growth and profitability and exercise patience, you should be able to generate sufficient returns to compensate you for both the time and risk you have taken. So as long as you have the nerve to tolerate some volatility then value investing over the long term may be the way to go.

Current Happenings in Local and International Markets:

- T&T budget based on US\$70 oil price; experts say price is too high
 - T&T warned: Brace for fallout from US crash
 - Jamaica Producers exit UK banana export business
 - Alternative sources of energy high on agenda in Jamaica
 - Ethanol exports, higher poultry prices push Jamaica Broilers Q1 profits
 - WaMu becomes biggest bank to fail in US history
 - JPMorgan Chase buying Washington Mutual's assets for \$1.9 billion after FDIC seizes bank
 - Bush scrambles to save \$700B bailout plan
 - KB Home 3Q loss widens as housing slump drags on
 - HSBC to cut 1,100 jobs worldwide
 - Delta and Northwest shareholders approve combination to create world's biggest carrier
 - Wrigley shareholders approve \$23 billion sale to Mars, creating world's largest candy maker
 - 30-year mortgages jump after 5 weeks of declines
 - Brazil Jobless Rate Falls to Second Lowest Since 2001
 - Paulson Plan May Push National Debt to Post-World War II Levels
 - Goldman, Morgan Stanley Bring Down Curtain on an Era
 - Bernanke Moves Closer to Rate Cut as Risks to Economy Intensify
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Table 1: Regional Market Performance (as at 25 September 2008)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	1,086.37	-1.05	-4.33	10.62	16.53
All Trinidad	1,460.32	-1.05	-4.14	21.62	24.53
JSE Index	103,564.84	-1.08	-3.66	-4.08	7.76
JSE Select	2,833.06	-0.33	-5.26	-3.27	6.75
All Jamaica	103,600.37	-0.14	-4.83	-2.98	5.65
BSE Composite	1,037.41	-1.52	-3.22	0.84	5.60

Table 2: International Market Performance (as at 25 September 2008)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	1,209.18	0.22	-4.55	-17.65	-20.30
Nasdaq Composite	2,186.57	-0.57	-7.57	-17.56	-18.52
Dow Jones Industrial	11,022.06	0.02	-3.20	-16.91	-20.01
German Dax	6,173.03	5.28	-1.97	-23.48	-20.55
FTSE 100	5,197.00	6.50	-5.61	-19.51	-18.76
Nikkei 225	12,006.53	4.50	-6.77	-21.57	-26.80
Hang Seng	18,934.43	7.38	-10.28	-31.92	-28.69
DJ Eurostoxx	3,207.11	6.87	-2.23	-27.11	-25.91

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