# Investors must tread carefully

TIM HUNTER Last updated 05:00 21/07/2013
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ON THE MONEY: London-based Kiwi Richard Boon predicted a ‘‘monster bear market rally’’.

OPINION: Four years ago, hedge fund manager Richard Boon was talking about "a monster bear market rally". There was a "once in a generation" opportunity to buy shares, the London-based Kiwi told me.

Many of the world's sharemarkets at the time were just recovering from a steep plunge triggered by the financial crisis, which reached its nadir in March 2009.

Boon was right.

In June that year, when the head of Artefact Partners was sharing his views, the S&P500 had already steamed ahead by 40 per cent, but it had more in the tank and didn't stop for a breather until April, 2010, having almost doubled on a year earlier.

However, huge moves like that are rare, and it's even rarer for investors to pick them correctly.

So are sharemarkets overvalued right now? After some impressive gains over the last year or two some commentators, particularly in America, are arguing that another correction is due.

Unfortunately, amid the torrent of argumentative data, it can be difficult for investors to find their feet, although some of it contains entertainingly waspish remarks.

A current favourite of mine is this from Australia-based Kiwi investor John McMahon, debunking "real estate nut cases" who say now is a good time to buy property because interest rates are low.

"The best time to buy is obviously when interest rates are high, because then property values are likely to be low," he wrote last month. "Low interest rates, all else equal, cause property prices to be high, so why would anyone want to buy when asset values were high? This basic logic escapes followers of the knuckle-dragging property-spruikers."

McMahon is a former head of ASB Securities and ex-head of equities for ABN Amro. These days he just runs his own money and keeps a low profile, but he regularly publishes his views and investment performance on his website as a form of discipline.

As a result we can see that McMahon's portfolio was heavily weighted to cash last month, as it has been for some time, with about three-quarters of its assets in Australian or US dollars.

The weighting reflects McMahon's perception that equity markets are relatively fully valued and his pessimism about the outlook for world growth over the next two years.

He could be right. The investment performance he posts on his website is certainly impressive.

Another bearish commentator is John Hussman, of US-based Hussman Funds, whose Strategic Growth Fund controls about US$5 billion in assets. Last week his regular market report warned of "overvalued, overbought, overbullish conditions that, from a cyclical and secular standpoint, should probably have [investors] wide-eyed with terror."

Amid withering criticism of the Federal Reserve, Hussman wrote: "we remain convinced that recession risk remains palpable" in the US.

Hussman has a track record of persistent pessimism, prompting one critic to compare him to a broken clock which tells the right time twice a day. Back in early 2009, when Boon said he was "pounding the table" in enthusiasm for buying shares, Hussman was conceding the possibility of a rally, but only just. "The fund does have about 1 per cent of assets in call options essentially to ‘soften' our hedge in the event of a strong market rebound," he wrote, "but that ‘anti-hedge' is more like insurance than expectation."

Hussman's fund reports average annual returns since inception in July, 2000, of 4.4 per cent, which seems a bit, well, meh.

Not everyone is as downbeat as Hussman. A market view from Wellington fund manager Harbour Asset Management this month discussed the implications of the big economic picture on investment choices.

The firm noted rising volatility and above-average share values, but its reluctance to get too negative shone through.

"While we can be concerned about risks such as a slower outlook for Chinese growth, or a further bout of European stress, the fact is that global growth is improving and interest rates are likely to stay low for the foreseeable future," it said.

"If we are right and economic growth continues to gradually improve, then both cyclical and growth stocks are likely to continue to out-perform defensive stocks."

Harbour's view is a lot less alarming for investors than Hussman's. This doesn't mean it is right, only that it shows more than one way of looking at the world. Which is part of the problem. The macro market view is rarely as clear as it was when Boon was making his big call in 2009 - and even then it was pretty murky.

One way to deal with the foggy big picture is to focus close up and look for individual companies that won't run screaming from the slightest economic mouse.

Many professional investors take this approach, even if they also consider macro-economics. Chris Swasbrook, at Elevation Capital, for example, doesn't worry too much about what the Federal Reserve or the European Central Bank get up to.

"History shows that people have made more money in the stock market by understanding what business they are investing in, than by speculating on what politicians or central banks do," he says.

Take Nestle, he says. People see Europe as economically stagnant and politically shaky, but it contains individual companies of global scale, like Nestle. "I'd argue quite strongly it's one of the best managed companies in the world, probably second only to Berkshire Hathaway, and has wonderful franchises."

Figuring out which businesses are worth buying is of course not easy, but it's probably easier than figuring out how the world's economic forces will apply themselves.

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