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INVESTMENT PORTFOLIO FOR THE NEXT BULL MARKET

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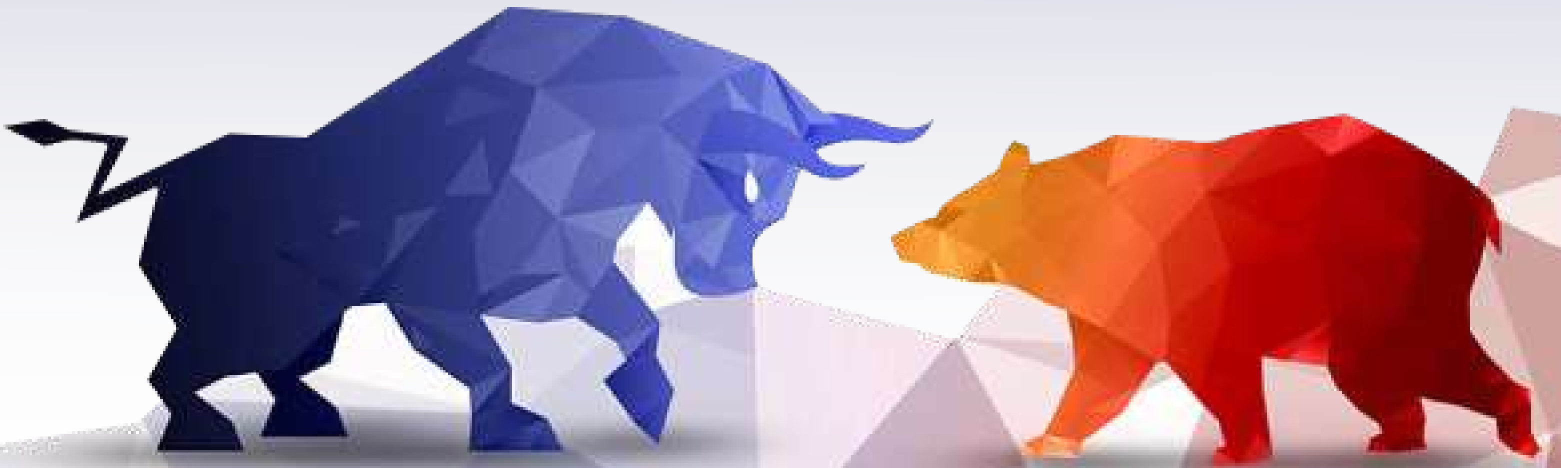

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Learn All About Securities and How to Build a Diversified Investment Portfolio

Investment Portfolio for the Next Bull Market

Article

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The 'FBM KLCI' (FTSE Bursa Malaysia Kuala Lumpur Composite Index) dropped 12 points, or 0.9%, immediately after the Malaysian government extended the Movement Control Order (MCO) to stop the spread of the SARS-CoV-2 coronavirus. The reduction in domestic economic activity also led Fitch Ratings to revise Malaysia's sovereign credit rating outlook to negative, undermining Malaysian export earnings from commodities, manufacturing and intermediate goods, and tourism receipts.

The disruption caused by the COVID-19 pandemic has forced the whole world to change – for better or for worse. Life has become a pressure test, as nothing and no one has been spared. The markets too have not had it easy – and that means we must check if our own financial reservoirs have been properly built or not.

Given that Malaysia's MCO is still in force, this is a good time for us to assess the financial health of our investment portfolio, take the appropriate measures and prepare in advance for any upcoming opportunities or roadblocks.

Before any changes are made to your investment portfolio, it is crucial to conduct a review exercise, either by yourself or with someone you trust. When reviewing your current investment portfolio, confront these points and make a note of your responses:

1. Investment Goals

Looking at your existing investment goals, are you now ahead, on par, or behind the returns that you have set for yourself? What is the gap?

2. Risk Appetite

Has your risk appetite changed in tandem with your lifestyle? Do you have more capital to invest now? Aced that promotion at the office and now you have more cash inflow? Marital status changed or ready to have a family?

3. Asset Allocation

Are you content with the current asset allocation? Are there any changes you would want to make to improve the portfolio?

4. Frame of Mind

Are you emotionally neutral when asking yourself the above questions?

Portfolio Revision

Once you have an idea of what you would want to see in your ‘revised’ portfolio, here are some suggestions that you could consider implementing.

1. Pick blue-chip stocks and the price you would pay

"Be fearful when others are greedy. Be greedy when others are fearful."

Going by what Warren Buffett said, there will be a clutch of investors who release some of their stocks on hand, and among those stocks will be blue-chips.

Analytical reports (similar to the table below) show that the gaming, tourism and hotel businesses have been severely affected. Your decision to buy into these or not will depend on what you asked yourself during the review exercise.

List around 20 to 25 blue-chip stocks that you are interested in. Do your research on them. Set for each one a price you are willing to ‘buy’ at, and then monitor them diligently on a constant basis.

Counter	Price at noon market break	YTD change (%)
Genting Bhd	2.92	-50.65
Malaysia Airports Holdings Bhd	4.04	-46.84
Petronas Chemicals Group Bhd	4.09	-44.35
Press Metal Aluminium Holdings Bhd	2.77	-40.43
CIMB Group Holdings Bhd	3.11	-39.61
Genting Malaysia Bhd	1.92	-39.56
Public Bank Bhd	12.6	-35.19
Hong Leong Financial Group Bhd	11.6	-31.36
Hong Leong Bank Bhd	11.92	-31.10
FBM KLCI	1,209.28	-23.89

2. Put index funds in your portfolio

If you have only unit trust funds in your current portfolio, why not gear up and add in index funds? Your unit trust fund might be on the active side, and probably you have an agent to help you on that, but adding in index funds that are passively monitored helps you to diversify your risk and bring down the cost of transaction.

Market wisdom suggests that the ideal time to invest in index funds is during a strong bull market. As stock prices increase across all sectors, actively-managed funds like unit trust funds might lose their advantage as fund managers will have a hard time trying to beat or match the market. However, index funds have little need for managers and can generate returns without intervention.

An example of a solid index fund would be FTSE Bursa Malaysia KLCI ETF. This Exchange Traded Fund is an index fund. As Bursa Malaysia puts it, it is ‘a basket of securities with the objective of mimicking the performance of an index’. This basket can be made-up of shares, bonds or commodities, depending on the index that the ETF is tracking. In addition, it is cost effective and simple. If you have only a bit of capital to invest and face time constraints to monitor your investment, this kind of index fund could be the right choice for you.

3. Look out for undervalued stocks

Going after undervalued stocks, also called value investing, is a popular method to punch in the profits. It involves choosing stocks that appear to be trading at a lower price or book value.

The concept is akin to purchasing an expensive item at a very low price. However, bear in mind that, although it is conceptually easy, value investing requires active effort in monitoring and selecting the right stocks.

In practical terms, this focuses on investing in a quality company that you think is undervalued. Your decisions should be based on strong fundamental analysis. The strategy involves buy-and hold, looking into market reactions and dividend pay-outs.

Benjamin Graham, the economic theorist called the 'Father of Value Investing', said that an intelligent investor performs a complete and in-depth analysis before investing, as doing so allows them to derive a safe and steady stream of returns on their investments.

Pricing is also important as the intelligent investor will buy a stock when the price is below market price, which is below its intrinsic value. Practising this method might very well shape the investor in terms of patience and the understanding to discern whether a stock is worth investing in.

Willingness to invest time on research and holding on to your stocks for a long term make up one set of the required traits for a value investor. There are ample resources online and it is worth listening to recognised investors willing to share their ideas and experience. Updating yourself with such information will enrich your understanding and might even ignite your interest to begin value investing immediately.

4. Test your diversification plan

The concept of diversification typically attempts to answer whether we can get higher returns at lower risk. One method to measure diversification is to use the Modern Portfolio Theory (MPT).

MPT has three measurements to it: returns, risk, and correlation

- For returns, the combined income and capital gain (or loss) from investment is measured.
- Risk is measured by the standard deviation of the returns, where a higher risk is reflected by a higher standard deviation.
- Correlation is a measure of the degree to which two assets move at the same time. Two assets moving simultaneously in the same direction show a positive correlation. Their simultaneous movement in the opposite direction indicate a negative correlation. A zero correlation means the movement of the two are not related. In reality, most assets exhibit a positive correlation.

When you want to increase returns, and decrease risk overall in your investment portfolio, you should diversify the allocation of assets in your portfolio such that their statistical correlations to each other are positively related. In other words, MPT advises against putting all your eggs in one basket.

The theory also states that there are two types of risks for individual stock returns – systematic risk and unsystematic risk.

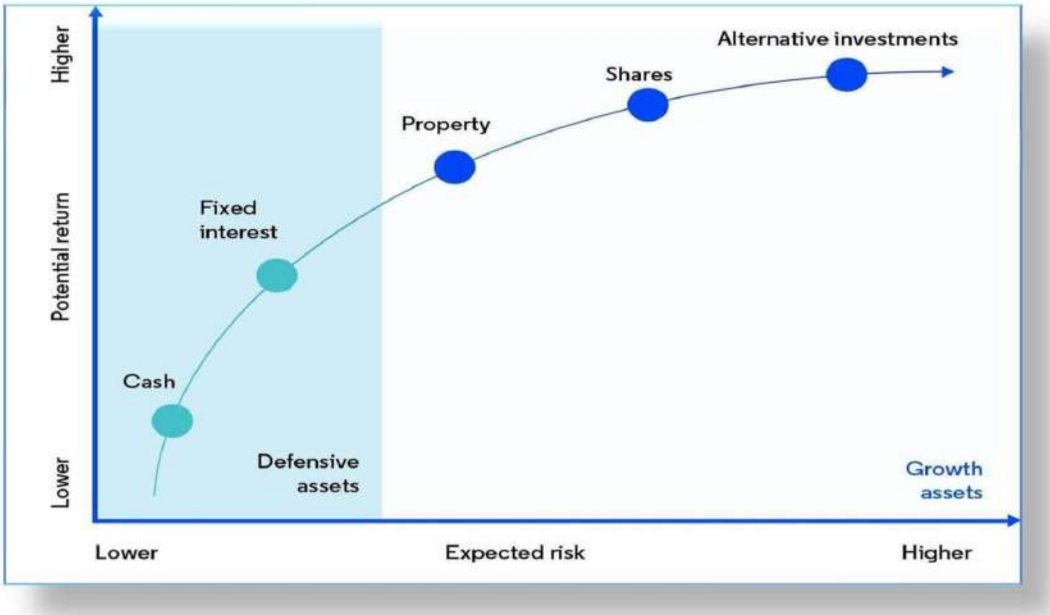
Systematic risk is a market risk, which cannot be diversified away. For example, interest rates, recessions, wars and the COVID-19 pandemic are unpredictable market risks.

Unsystematic risk is a risk that could be diversified away as the number of stocks in the portfolio increases. It represents the component of a stock's return that is not correlated with the market movement.

However, while we want to build a portfolio generating high returns at low risk, we must always remember that our portfolio will certainly face risks that cannot be mitigated entirely.

5. Remember your investment objectives

When attempting to add in blue-chips or index funds, and when leveraging on value investing, it is important to remember your investment objectives that you noted down earlier.



On the chart above, investment goals are expressed in terms of risks and returns. Your tolerance for risk depends not only on your personality but also on personal factors such as marital status and age. The potential investment returns goals can be classified as capital preservation, capital appreciation, current income or total returns.

1. Capital preservation

Earn a rate of return comparable to inflation. One concern is about maintenance of purchasing power so that the real rate of return matches inflation.

2. Capital appreciation

Earn a rate of return exceeding inflation. Purchasing power increases over time through capital gains.

3. Current income

Earn returns that generate income, usually a supplementary income to take care of some planned expenses.

4. Total returns

Earn returns that grow in value through capital gains and reinvestment of the current income. This is riskier than the current income objective but holds less of a risk than the capital appreciation objective.

By clearly marking out your intentions about your investment goals, you are now ready to explore and revise your new investment portfolio, preparing you to take advantage of the next bull cycle.

In addition, when you set your investment goals upfront, it is easier for you to set a targeted return and speak with your investment manager (if you have one) and, at the same time, prevent him or her from being excessively ambitious in their investment style or churning the account to obtain more commissions. Here, you are the one in control.

What Next?

The suggestions here can be used separately or together to revise your portfolio. However, what remains critical to crafting your 'best' portfolio is the consistent review or evaluation of your investments. Albert Einstein’s observation that "the definition of insanity is doing the same thing over and over again but expecting different results" rings true for those who anticipate better results without doing anything to rectify the mistakes they have been stubborn about.

Taking action to review your portfolio is a critical first-move to a better portfolio. But what is of even greater value than the numbers reflected in your portfolio is your mindset.

When we see fit people, we know they must have spent a considerable amount of time to build and work on their body. They also have to be intentional about their decisions – the decision to exercise at least a few hours a day, the decision to eat better, and so on. These decisions usually come from within and are prompted by the desire to improve their physique. In the same way, when we read about a successful investor or hear about others with great returns on their investments, we must not be dismissive. Instead, we must remember that it takes much time and commitment for anyone to reach that level.

Continue to track and study in depth the companies and their industries that you like before adding those into your portfolio. Slow down and think rationally. As you continue to grow your investments, you will soon find out that regardless of whether the market is bullish or bearish, one maxim about investing is most certainly true - it pays to be prepared.