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## How smart investors make the most of market turmoil?

***Vikas Gupta***
*ArthVeda Capital*

In times of turmoil the doomsayers come out of the woodwork shouting the end of the world. They profess safeguarding the capital and booking losses or profits and going into cash. They sound sophisticated, expert and erudite. They sound like they know what they are talking about. It becomes the fashion to predict further falls in the markets. What is in dispute is by how much and how soon.

The momentum investors and the trend followers love to follow the momentum or the trend and start with selling their portfolios and take it further by shorting. This exaggerates the turmoil and lots of margin traders get shaken out of their portfolios and have to close out their positions as quickly as possible with as much capital they can save as possible. This amplification on downsides is what causes sudden downfalls or “crashes” in the markets. The turmoil spills over into other asset classes since the losses or margin calls in one asset class need to be supported by exiting positions in other asset classes. Which causes further downfalls in still other asset classes. All of this makes for a correlated crash across multiple asset classes and it seems like the “sky is falling”; chicken littles are bound to come out screaming in terror.

The fundamental analysts start projecting fundamentals which are worse. This is partly driven by truth in certain sectors which are directly impacted by the crash in certain asset classes and partly by trying to predict a fundamental reason for what is essentially a belief in near-term technicals, i.e. trends.

The macro-economists start to project dire economic projections of the GDP. GDP is slowing down, deflation or inflation is round the corner, interest rates are rising or might stay low for too long, assets are overpriced, some other assets are crashing. There is only economic dystopia round the corner.

What do the smart investors, i.e. believers in intrinsic value of asset classes or value investors in simple words, do at such times?

The smart investor loves Turmoil; because turmoil is usually accompanied with uncertainty. Uncertainty is accompanied pretty soon with lots of stocks available below their intrinsic value.

The smart investors’ are anchored in the intrinsic values and hence look at the conservatively estimated intrinsic values of securities. They compare those to the current market prices. If they find a substantial discount to conservatively estimated intrinsic values they start buying. Within the cheapest stocks they start segregating the companies which have higher quality, higher profitability, higher margins, low or zero debts. If such companies are available significantly below their intrinsic values, they are the first preference.

Once a smart investor buys the stocks are bound to fall further because the smart investor does not try to catch the bottom. Their criterion is whether the stocks are available significantly below their intrinsic value with a huge margin of safety. It is not their concern that the stock should be purchased at its bottom or that it should start going up as soon as they buy it. They are ok with significant drawdowns in the investments post investing. If they have more cash they might invest more with each major downfall. Probably stagger the purchases in 3 to 5 steps.

Smart Investors remind themselves that people continue to eat food, buy clothes, buy or rent shelter. Further, they continue to buy smart phones, continue travelling, probably spend even more on entertainment to drown out the terror screams. Yes, some earnings could be lower but that doesn’t mean that the total earnings have dropped. The book values are mostly stable probably growing. The overall long-term earning power is intact for most companies and the dividends are still available, though some could be lower than normal.

Finally, the smart investors remind themselves that if the world is really coming to an end then their moving out of stocks into fixed income or cash under their mattress will probably not help. If the world is not coming to an end then sticking with 20 to 30 high quality stocks available below their intrinsic values can be a good diversified portfolio.