

# The Australian

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## Steering a path to financial success

- Richard Hemming
- From: **The Australian**
- September 14, 2011 12:00AM



You do well from not following the herd, says David Paradice of Paradice Investment Management. Picture: Stuart McEvoy  
*Source: News Limited*

**AN avid investor friend recently purchased \$600,000 worth of CBA, ANZ, NAB, Westpac, BHP Billiton and Rio Tinto on August 9, after the market had fallen just more than 11 per cent in the preceding five trading days.**

Four days later, he was sitting on a profit of \$30,000. Should he take the profit or hold on, was his question.

As it happens, he hasn't sold, and at the time of writing was trumpeting that his investment profit was more than \$70,000, even including brokerage costs if he chose to sell.

According to Madhu Veeraraghavan, a professor of finance at Monash University, this is exactly the type of behaviour that would be expected, but these actions are also wrong.

"If you've made a profit, you should book it and then you should go," he says. "It's the greed factor. If you are greedy you want more and you are willing to take more risk than you are really comfortable with."

More common than the scenario above, however, are investors, big and small, being caught in the volatile markets on the other side of the coin, losing money.

Even after recent rallies, the ASX All Ordinaries Index is down more than 17 per cent since mid-April. And there are abundant signs that the volatility will not go away. If anything, it will increase.

Many investors are asking themselves whether they should sell their stock holdings, hold on or buy more at the lower prices.

Veeraraghavan says the tendency to hold on and hope is magnified among those who are losing money.

"If he is losing it will hurt a lot more," he says. "If he has made \$40,000 he would say he is very smart and be overconfident but could possibly take his profit and walk away. Just say he made a loss of \$40,000. No matter what, he's not going to walk away."

Another point he makes is that no matter whether the investor is a manager of billions for a bank or a so-called mum or dad individual, they will still have such emotional or cognitive biases: "Just because you're a Wall Street guy, it doesn't mean you're not affected by fear and other emotions."

With this in mind, Wealth spoke to several professional investors.

All insist that far from sitting on their hands, they have been taking advantage of market weakness to increase their positions in stocks, or "average down", and to buy new ones.

Not surprisingly, no one admitted to selling into the weakness.

Paradise Investment Management founder David Paradise says that he does not look at the market per se but at stock-specific news. A recent example he highlights is when his fund increased its holding in Sigma Pharmaceuticals, the owner and distributor of the Amcal and Guardian brands.

"You do well from not following the herd, definitely," he says. "In Sigma we averaged down recently after it fell off the back of a negative broker report.

"We are stock specific, so if a stock falls we'll buy it if it stacks up; we're not trading the market."

Heath Behncke is a director and investment manager at Sigma Funds Management, which was established just as the financial crisis was fading in August 2009 and the sharemarket was surging. He says that it has only been after these falls that his fund has purchased stocks whose earnings are highly leveraged to economic conditions, known as "cyclicals". These include steel-makers BlueScope and OneSteel, as well as retailer Harvey Norman and financial-services provider AMP.

There is no doubt that these stocks look to be good value. Harvey Norman, for example, trades on a price-earnings ratio of eight times (compared with the market average of more than 11 times) that factors in future losses, according to Behncke.

By contrast, his fund has been selling stocks that have performed well but are mainly those with defensive earnings that should increase regardless of the economy. These include utilities such as AGL and beverage manufacturer Coca-Cola Amatil, which trades on a forecast PE of about 16 times. These stocks are now expensive, says Behncke. "The dichotomy in the market is that the defensives look okay in an absolute sense, trading on sensible multiples, but they are becoming expensive compared to everything else," he says.

"To sell or not to sell," is not a question some fund managers believe they have to ask themselves.

For example, Smallco's Craig Miller says his fund is concentrated among a few key holdings, which means it does not sell, even if it has short-term concerns: "The market doesn't always behave rationally for stocks and it's hard to pick the right moments, even when there is bad news. For good stocks, the market can be very forgiving, so it can be a recipe for disaster to sell out of good stocks."

Back to my friend, and his lucky conundrum. Veeraraghavan says the friend should go back to the drawing board, sit on a mountain, and do some analysis of his "risk profile". "He needs to work out what his risk tolerance is. Some might be unwilling to accept a 1 per cent loss, while for others it might be 10 per cent. He needs to work out what will make him happy." Maybe he should sell and invest in a yoga mat.

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