LEARN TO LOVE THE LONG TERM

of what is happening on an economic and market level globally, but are yet to be imputed into company forecasts and share prices. Investment markets will ultimately normalise as we look through the cycle, however there are significant opportunities on the upside and downside in the interim.

Harman: We expected earnings growth rates to be in the midst of whipsawing from 20 per cent positive growth a year ago to 20 per cent declines in the year ahead, and they are. The central message is that profits are in free fall, destination unknown, not what the particular number is at a point in time. Also note that the December-half 2008 numbers relate to a period when the economy still exhibited patches of strength. The June-half 2009 results, reported in August, will be significantly worse than the results now being reported, and the December half will be worse again.

Xiradis: Earnings expectations were lowered considerably leading into the results season. Despite this there have been some disappointments, but equally some companies have shown themselves to be resilient. Some stocks that have disappointed have been Bendigo and Adelaide Bank, Brambles, Centennial Coal, Spotless and TPI Industries, while positive surprise arose from the results of Coca-Cola Amatil, Lihir Gold, ResMed, Commonwealth Bank of Australia, JB Hi-fi and CSL. On balance, the reporting season has slightly exceeded the very pessimistic market expectations.

We've seen Chinese interests move in to buy stakes in Australian companies. Is this positive or negative for investors?

Conlon: As the Western world struggles with excessive leverage, it's understandable that the areas of the world that have been lenders rather than borrowers are in the best position to recapitalise businesses or assume ownership from weak holders. Allowing good-quality businesses trading at distressed prices – often due to financing concerns – to survive is undeniably positive, not least for the Australian economy and the employees of the business. Selling businesses to foreign investors may not always be palatable. However, without a more proactive stance by Australian investors in refinancing businesses, it is likely to be the only option. Running away from companies in need of funding or, worse, allowing investors to exacerbate the situation through shorting isn't likely to provide the solution.

Lele: [It is] positive from a short-term perspective in that both shareholders and employees are benefiting from further investment into the companies, and in some cases the companies themselves are being saved from the effects of an extremely sharp turn in the global growth cycle, to which many of these companies are leveraged.

Longer term, we view such moves as a negative. In an environment of money printing on what may well become a global basis, money has less value – the utility of it falls for every new unit of currency that is created. In this environment, scarce assets have even greater value – as the scarcity of money decreases, the scarcity of other goods, in relative terms, increases. Australia is abundant with these assets: selling off these assets, whose scarcity will increase, in exchange for money, whose scarcity will decrease, is a poor economic outcome. While the prices paid in some cases may reflect this increasing scarcity, to a degree justifying such sales, if we do not redeploy the money we receive into equally or more scarce assets, we will be worse off, as in real terms the money itself will decline in value.

Harman: In a world where buyers are hard to find, you can't be worse off if a cashed-up purchaser appears. A longer list of bidders increases your options. If you don't think a particular deal is attractive on its merits, or if you would rather buy specific assets yourself at that price via a rights issue to existing shareholders, then as a shareholder you should vote against the sale of stakes and/or assets where you have the opportunity to do so. Given the distressed pricing of many quality assets all around the globe at present, as an Australian investor you also have plenty of opportunities to buy assets in foreign national jurisdictions if you want to play that game. They will no doubt be delighted to hear from you.

> **The east European situation can only exacerbate the call on scarce capital.**
> Graham Harman

Xiradis: The emergence of Chinese interests has been both positive and negative. In the current credit-constrained environment Chinese interest has effectively underwritten the survival of several domestic mining companies. Two major competitive advantages of the Chinese companies have been access to funding and a long-term investment horizon – both crucial in this environment. Most domestic corporates lack one or both of these key criteria and have been unable to participate in the recent round of corporate activity. This is unfortunate because the trade-off required to secure survival has been the transfer of (mostly) high-quality assets at heavily discounted prices.

Europe, particularly eastern Europe, looks like the next ticking time bomb. What will be the impact on the Australian sharemarket?

Conlon: As is generally the case at present, negative news is embraced with considerable enthusiasm. EastEuropean debt will cause issues, particularly in smaller nations with more severe imbalances. The direct impact on the Australian market is highly unlikely to be material however, it is the sentiment issue again that is likely to be more severe. From our perspective, this latest crisis only emphasises the need for banks globally to be considered in their approach to resolving the problems, as their role in restoring confidence remains crucial.

Lele: The issues in eastern Europe are significant and should not be underestimated in terms of their impact on global markets. As our global strategists note, they present risks to the euro zone as well as the global economy. There has been an extreme increase in Europe, Middle East and Africa (ex-Russia) leverage over the past decade. This was funded largely by foreign debt as shown by the deterioration in the region's current account position. Total net foreign liabilities for EMEA ex-Russia are around $US1 trillion ($1.5 trillion). Around $200 billion of foreign debt is due this year. High levels of foreign debt are extremely problematic when a currency comes under pressure. As it depreciates, the debt ratio threatens solvency and increases the risk of default.

To us the east European situation appears worse than the Asian crisis. The Asian economies were more flexible and there was much less of a synchronised downturn across the global economy than there is now and thus the Asian countries could export their way out of trouble. Additionally, the International Monetary Fund and World Bank had more money for support packages. Notwithstanding the impact to global markets (to which Australia is correlated), and the ancillary effects of this on Australian corporates (in terms of lesser availability and higher cost of liquidity), Australia's direct exposure from a bank or sovereign perspective appears significantly less than the euro zone's, and our markets will be less directly affected.

Harman: Globalisation is a luxury item. In every boom corporations expand across the planet, and in every bust they pull their capital back home. Australian banks and borrowers have already run up against this hurdle, and the east European situation can only exacerbate the call on scarce capital. More generally, the Australian sharemarket in 2009 is the centre of a battle royal between excellent value and appalling momentum. Significantly deteriorating newsflow in recent weeks, not only in eastern Europe, but in Japan, China, the UK, the US – indeed, just about everywhere you look – means that the negative momentum probably retains the upper hand in that battle for now.

Xiradis: The outlook in Europe is quite poor as conditions rapidly deteriorate. The immediate impact on Australian corporates will be the continued repatriation of capital back to these economies, pressuring domestic banking syndicates to refinance. In addition, for companies operating in Europe this will result in a worsening earnings outlook, leading potentially to more downgrades.

The time to be greedy is when others are afraid

Report David Coe

Great investors have secret knowledge that makes them big money while the rest of us are running scared.

Technically, it is that fast moves come from false breaks of previous ranges. On a chart, it looks like the price rising above old highs (or dropping below old lows) and then retreating.

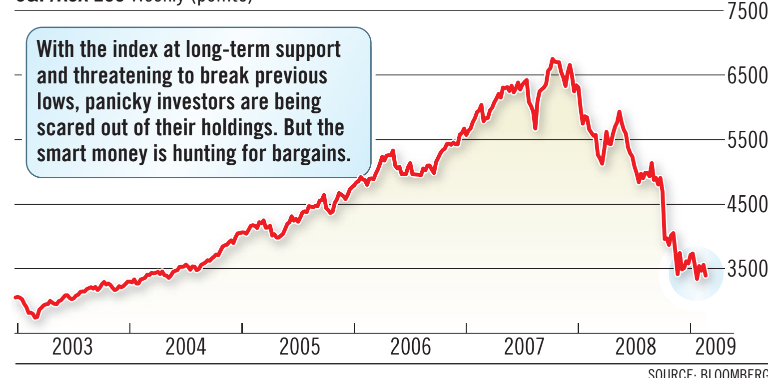
At times like this, when stocks are threatening to crash down through long-term support levels, emotions run high and many investors sell out for whatever price they can get.

But when the last of the sellers is gone, prices can only rise. That's why market professionals say retail clients always sell out at the bottom of a market.

Tycoon industrialist John D. Rockefeller summed it up succinctly: "The way to make money is to buy when blood is running in the streets."

It also works in reverse. When everyone is exuberant and confident the market is going higher, but when the last buyer is on board prices can only fall.

Fear and greed



SOURCE: BLOOMBERG

As legendary investor Warren Buffett says: "The time to be greedy is when others are afraid. The time to be afraid is when others are greedy."

And people are afraid. Very afraid. With world markets retesting levels first seen years ago, it is easy to find people who believe shares are too risky. The conversation at dinner parties and barbecues is turning to how far the market can fall. There have even been calls in the media to rethink the logic of compulsory superannuation.

But the smart money is hunting for bargains and picking up assets from terrified investors.

Two remarkably successful analyst-traders who use various methods to see below the surface of markets agree genuine buying opportunities are emerging.

Institutional investment adviser Jake Bernstein, who advises a number of American banks and hedge funds that survived the financial crisis, said earlier this year he expected shares to bottom in the first quarter. Now he says there has never been a better time to buy equities – at least since the 1920s and '30s.

Bernstein says commercial players in the commodities markets have used the falling prices to unwind their hedges and establish long positions.

"Natural gas, in particular, has a huge amount of long positions," he told the *Weekend AFR*, also citing oil, copper, other non-precious metals and agricultural crops, particularly biofuels like sugar and corn, as commodities in which the long positions of commercial players will underpin a sustained rally.

David Hunt, an economist and strategist at boutique broker I-Deal who picked every major top and bottom in the S&P/ASX 200's 15-month slide, not only agrees that the market will bottom soon, but goes further and says that by Tuesday the market will have started working its way north.

Hunt's record has been remarkable. By mixing fundamental analysis with charting methods, Hunt called tops in the S&P/ASX 200, BHP Billiton, Fortescue and a swag of stocks within days of their 2007 peaks. He then correctly forecast the timing and levels of the index's intermediate peaks and troughs, including the recovery from November to early January's, before the fall into late January's lows.

Hunt, also president of the Australian Professional Technical Analysts Association, correctly picked February 12 as a turning point more than a month before. On February 13, the index peaked and then began its latest run down, which Hunt confidently says will be over by Tuesday.

After that, he says, the market will climb in a choppy manner to 4200 in May and then rally to 4800 in September, when the last, most severe leg of the bear market is possible.

How will you know whether the market is likely to topple?

If taxi drivers start telling you what stocks to buy, if shares are again the topic of dinner party conversations, and if everyone is greedy for a slice of the action. Remember Buffett's words.