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Good time to pick some stocks

Integrating economic, technical and fundamental analyses could help us in our investment

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THE best thing about 2009 is that 2008 is over. It has been a year which most want to forget. We see almost every conceivable asset class going south, from property, commodities, equities, bonds, money market funds, structure products and hedge funds. To top it off, we ended 2008 with a US$50 billion scam by "Mr Made-off" with your money. By now, all the investors with money have no more guts to invest and all those with guts have no more money.

Recently, I read an interesting article entitled "8 really, really scary predictions" and I am sure many have been paralysed by fear after reading it. In the article, Nouriel Roubini, also known as Dr Doom, says we are in the middle of a very severe recession that's going to continue through all of 2009. In the US, it is the worst one in the past 50 years. He thinks that advanced economies are at the start of a hard landing. Emerging markets are in a serious slowdown, starting with China. He thinks that cash is the likely place to put your assets.

Robert Shiller, the Yale professor who successfully called both the dotcom and housing bubbles is equating the current cycle to the Great Depression, sans the level of unemployment. There is a likelihood that the US stock market could fall by another 50 per cent from here when he compares the PE to what it was after the crash of 1929, which is about six.

Jim Rogers, the commodities guru, who two years ago predicted the devastation of Wall Street by the credit bubble, now thinks that we are in a period of forced liquidation because of the impact of deleveraging. The only asset class which he thinks the fundamentals are not impaired is commodities.

On a more positive note, David Fuller, global strategist with Stockcube Research Limited, an independent technical analysis research company in the UK, has written an article with a compelling case for an eventual rally. Citing reasons such as available liquidity in the system pumped in by governments, record low-level interest rates in advanced economies, improved performance of corporate bonds relative to government bonds, diminished inflation fears and high levels of cash held by investors, Mr Fuller thinks there is a chance stock indices will surprise the bearish consensus.

All these well-respected financial gurus have a strong track record of making the right calls. Some are more optimistic while others are downright depressing. What should the ordinary investors do?

Can we still make sense of the foundation of investment? In this article, I will attempt to share some insights into how economic data, fundamental analysis and technical analysis integrate together to help us in our investment.

In the beginning of every year, analysts and market gurus make their predictions on what to expect for the year. Many are saying that economic data will continue to be negative for some time to come. GDP growth is expected to slow and unemployment to rise. On the other hand, valuation based on price/earnings ratio and price/book ratio is looking very attractive. Sentiment is still weak although it has improved somewhat because our financial system did not collapse. The technical analysis based on the Elliott wave theory is suggesting that we are either on a wave four of a three or a wave four and therefore more downside is expected as wave five unfolds. If we were to use Classical theory, the market is in a base-building process. How do investors deal with all the information which may be in conflict or complementary?

In evaluating the recent crisis, we learnt that economic, fundamental and technical analyses share a very intricate relationship. If we are able to understand the part played by each of these factors, we might be able to prepare ourselves better ahead of future financial crises.

Valuation of a company

Economic analysis involves the study of statistical data that enables us to identify trends in the economy. It includes GDP growth numbers, interest rate trend, employment numbers and more. Both leading and lagging indicators suggest that the economy is in bad shape now.

Fundamental analysis involves examining quantitative and qualitative information directly related to a company. By looking at a company's sales revenue, cash flows, earnings, dividend policy, growth prospects, debt management and credit standing, we can arrive at the valuation of a company. The quality of the company will depend on the management team, the product or service offered by the company and the strength of its competitors.

Moving on to technical analysis, the basic assumption is that human behaviour remains unchanged over time, giving rise to human and market psychology. It is this concept which allows technical analysts to spot trends and cycles in the market and individual securities. Humans have memory, thus resulting in supports and resistances used in technical analysis.

As we enter 2009, economic data is negative, valuation as defined by fundamental analysis is cheap, and technical analysis is pointing towards finding a bottom. If we are extremely negative because economic data is negative, we may miss the boat because market usually bottoms at the worst possible news and not when we see positive economic data. However, if we are aggressively buying because valuation is cheap, things can get cheaper before market turns around. Therefore, it is important to understand the relationship among these three factors and discover which the leading indicator is and which the lagging indicator is.

My observation is that we should make investment decisions using fundamental analysis as the first base. Depending on whether valuation is expensive or cheap versus historical averages, we then use technical analysis as a leading indicator to help us decide whether investing momentum is still intact, or poised for a breakdown. Economic data, therefore, will be the last to confirm the direction of the market.

The equity market seems to start off the year thinking the economy will climb out of recession by the second half of 2009, hence the rally. That is optimistic. When then will the economy recover? I am hopeful of this new year. If my observation is correct, fundamental analysis is now showing good value but market has not confirmed a bottom yet based on technical analysis. However, the bottom may be close. Now is a pretty good time for those with an investment time frame of three-five years to start selecting some investments and buy into them over the next 12-24 months to position for recovery.