This is one of the reasons why our clients sign up for CBC's 'Investment Monitoring Service' (IMS).

Fresh approach needed for volatility

Buy-hold strategy may have had its day

Bianca Hartge-Hazelman

Warren Buffett, arguably one of the world's greatest investors, once said that if you don't feel comfortable owning a stock for 10 years, then you shouldn't own it for 10 minutes.

The buy-hold strategy often promoted by financial planners is based on conventional thinking that, in the long run, markets always go up and will provide investors with a good return on their investment as well as tax benefits, despite any volatility.

But the Buffett line is now being questioned by many analysts, adding weight to the view that the traditional buy-hold approach to owning shares is dead and that volatility is, in fact, the new norm.

Bell Direct equities analyst Julia Lee says that while buy-hold does have merit, it works best in a rising sharemarket, not when markets are in the doldrums. "If you have a look at the experience of the last cyclical bear market between 1969 and 1980, the buy and hold strategy would not have worked throughout that whole decade," she says.

The Australian sharemarket peaked at 6828.7 points on November 1, 2007, but lost more than half its value during the financial crisis.

The index is still down nearly 39 per cent from that peak and still fluctuates wildly in response to news headlines and political announcements, causing prolonged uncertainty for investors.

Since the start of last August, the benchmark S&P/ASX 200 has spent most of its time in a 300-point trading range between 4000 and 4300 as investors dip in and out of riskier and defensive stocks.

Global uncertainty and the increased speed at which investors can trade shares electronically are two reasons why some experts believe that the traditional buy and hold strategy may have had its day.

"What we're seeing in the current climate is that all shares tend to go downwards or upwards together," says Yen Koh, JBWere investment strategist.

"Technology has also increased the visibility of portfolio returns to investors, which has led to a heightened tendency to focus on short-term returns and lose sight of the bigger picture."

There is another view that investing in shares is no longer as popular as it used to be, with trading volumes low and less money in equity markets due to ageing, changing pension regimes, growth of alternative investments and tougher financial regulations.

Ord Minnett investment strategist Simon Kent-Jones says: "I don't think they are necessarily turning stocks over any faster but I think people have changed their view on what is a good short-term trading profit, and I think they are taking those profit opportunities more regularly when they see them."

Ever since the boom turned to bust, investors have moved to more conservative assets with fixed-income characteristics.

"I think you have seen it with the increase in the level of term deposits and fixed-interest securities," Kent-Jones says. "A good example of that was the Woolworths notes that came out last month and [were] heavily oversubscribed."

> Look at the turning points – you're still riding a positive momentum and trying to avoid buying when there is negative momentum.
> Julia Lee, Bell Direct

The buy-hold strategy is often sold to investors by financial planners because it requires less management work – helpful for those with a large client base – as stocks are selected and held for many years.

Some experts are of the opinion that the strategy is fundamentally flawed because share prices tend to be volatile in the short term and can get well ahead of the intrinsic value of a business before falling back at a later date.

Management decisions and over-inflated forecasts can drive prices higher in the short term.

Roger Montgomery, chief investment officer of Montgomery Investment Management, believes even some of Australia's best-known companies, such as Qantas and Telstra, are examples of what not to invest using a buy-hold strategy.

"The share prices of both those businesses are less than they were 10 years ago and therefore owning companies like that for the long term is a mistake," he says. "You are better off putting your money in the bank."

Leyland Private Asset Management believes a buy and hold strategy can be good for investors as long as the stocks aren't too expensive.

"At the moment, the market is exceedingly cheap, providing opportunities to purchase businesses which provide a wonderful yield and offer significant potential for capital gains," it says.

"Two such examples are QBE Insurance and Telstra. In a flat market, it is nice to receive a reasonable yield while waiting for the growth."

Most broking houses will base their buying and selling decisions on a variety of tools such as intrinsic value or price-earnings ratios, which measure how cheap or expensive the market is before executing a trade.

Timing is also key to buying and holding any stock, whether for the long term or, at the opposite end of the spectrum, to actively trade.

Lee says: "It becomes important to have a look at the turning points, because what you are still doing is riding a positive momentum and what you are trying to avoid is buying when there is negative momentum."

Of course, most professional investors believe that investing in the sharemarket for any period of time is sensible only if you invest in quality companies.

"You want to buy a high-quality company with little or no debt, a high return on equity, great cash flow, a sustainable and competitive advantage and bright prospects for intrinsic value growth," Montgomery says.

He adds that investors should forget about the length of time they invest and focus more on owning shares in companies for as long as they continue to demonstrate those fundamental characteristics.

Australian Financial Review 15th January 2012

In today's economic climate successful investing requires a more 'hands on' and proactive approach. We do believe Buffet is still correct but what is important is highlighted in the final section. Proactive Monitoring of your investment portfolio is crucial to ensure you are always holding quality assets. This is fundamental in ensuring a portfolio that will outperform over a market cycle.

Call CBC on 1800 622 892 to find out more

General advice warning: The advice provided is general advice only as, in preparing it we did not take into account your investment objectives, financial situation or particular needs. Before making an investment decision on the basis of this advice, you should consider how appropriate the advice is to your particular investment needs, and objectives. You should also consider the relevant Product Disclosure Statement before making any decision relating to a financial product.