MARKET FLUCTUATIONS: A FRIEND OR AN ENAMY?

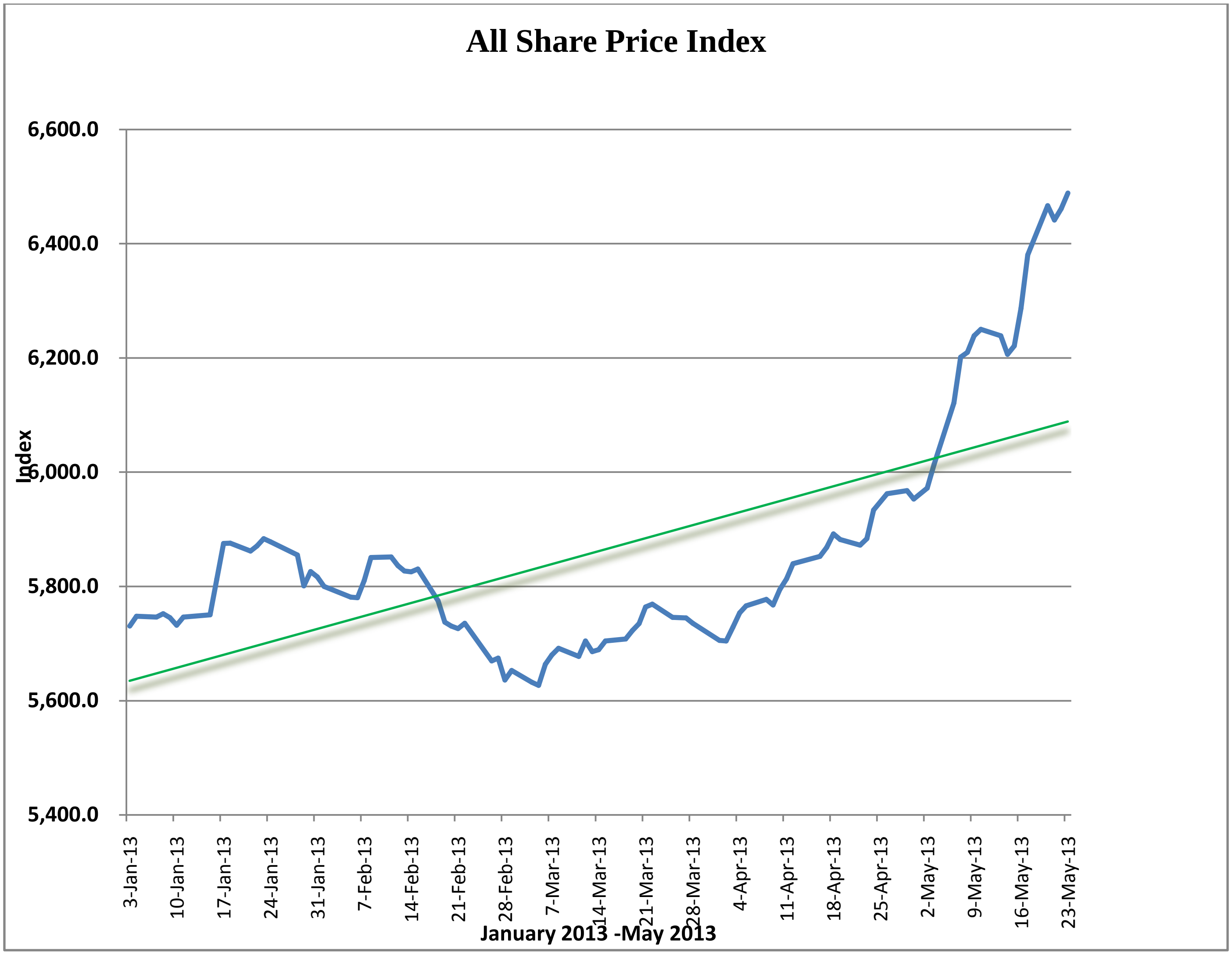

Figure 1- All Share Price Index

The stock market has out done many financial instruments in the recent past due to the high return yielded. The market has grown by nearly 33% since June 2012 and has already experienced a growth of around 14% for the current year. Further on, it has out done regional markets such as India, Pakistan, Vietnam, Cambodia, China and Indonesia and also the BRICK markets. Market Price Earning Ratio’s are still comparatively lower than our regional counterparts .Thus we have experienced considerable interest from foreign investors in the recent past. For example, the percentage of foreign activities in the market which was around 10% in 2011 and 24% in 2012 has already grown above 40% during the first five months of 2013.The Colombo Stock Exchange(CSE) has indeed proved to be a lucrative investment opportunity.

A point noteworthy is that the growth experienced was not achieved overnight projecting signals of stability in the market. This could be further justified with the S& Poor SL 20 (an index that monitors the performance of some of the fundamentally strong stocks) growing faster than the All Share Price Index (ASPI) during the current year. The market sentiments are geared at long term investment which is conducive for further growth in the market.

However when analyzing the movements of the ASPI (table 1) it is evident that eventhough it has grown in the long run it was subjected to short term fluctuations. It is a normal phenomenon in a market. One should not enter the market with a mind frame that the market will continue to grow. The price of a stock is a manifestation of the demand and supply for a stock. For an example when the demand exceeds the supply prices increase. The demand and supply of stocks are driven by market sentiments. There is a possibility of market sentiments changing. It cannot be forecasted with certainty that the market will continue to grow in the short run given the fact that it went up in the recent past. As long as one has invested in fundamentally strong stocks that are not over valued in price and he enters the market with a long term horizon he should not be alarmed of such fluctuations.

Further on, these fluctuations could be identified as stock market corrections. Even though it would seem painful in the short run, it is actually healthy because there is always excess speculation developed during the bull market and excess speculation is a hindrance towards a stable and growing market.

More over short term fluctuations of this nature spout unlimited opportunities. As once stated by Warren Buffet one of the most successful investors “look at market fluctuations as your friend rather than your enemy”

Valuable tips on maximizing opportunities in a fluctuating market.

- **“Don’t panic” –Douglus Adams**

The golden rule is not to panic and make rash decisions when there is a downward trend in prices. As stated if one has invested in fundamentally strong stocks that are not over valued in price at the point of purchase and he enters the market with a long term horizon he should not be alarmed of such fluctuations. Do your own research on the reasons for the downward trend. Don’t base your decisions on rumors. If you get alarmed and start selling your shares for no valid reason others will follow you and the market will go down further and increase the possibility of incurring more losses in the market. Bear in mind that a market is the combined behavior of thousands of people responding to information and market signals. Be a responsible investor and refrain from sending wrong market signals through your transactions.

- **“I buy on the assumption that they will close the market the next day and open in five years. Only buy something that you'd be perfectly happy to hold if the market shut down for ten years.” Warren Buffett**

The driving force behind investors behaving negatively towards short term dips in the market greatly depends on liquidity concerns of the investor. You should invest money that you will not need in the near future. It is only then that one would be able to maximize the profits in a growing market. Invest a certain percentage of your savings.

"I will tell you how to become rich. Close the doors. Be greedy when others are fearful." Warren Buffett

Investors usually invest when a market is going up. Differently stated at a point that demand and thereby prices are going up. When there is a down trend in the short run investors could buy shares at a lower price than before. Hence the average cost of the stock would go down and increase profits.

For an example if A buys 100 shares at the average market price of Rs 10 and the market witnesses a short term dip in the market and the price goes down to Rs 5, he could purchase another 100 shares at the given price. The average price goes down to Rs 7.50.

Don’t invest all the money at once. Purchase within a certain time span and under different market conditions to maximize the opportunities in a growing market.

- **“Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down.” Warren Buffet**

It is advised to invest in fundamentally strong stocks that are not overvalued and not in stocks that witness an upward movement in prices during a short time period for no valid reason. Experience form our stock market reveals that fundamentally strong stocks go down slower than the others when the market is experiencing a dip in the short run. Similarly such stocks would regain the demand and thereby the price faster than other stocks. There is a book value for a stock based on the performance of the company. Even if the price decreases in the short run it has to reach its book value before long.

- **"Remember that credit is money." Benjamin Franklin**

Refrain from excessive trading from margin trading accounts. The rationale behind margin trading is to purchase on credit and pay an interest on the principal amount until the stocks are sold at a higher price and the money is repaid. This process is successful in a bull market. If the trend is reversed and investors fail to pay the interest there will be margin calls. There will be excessive selling that would affect adversely on the market.

It could be concluded on the note that the movements of stock prices are subjected to fluctuations. It is an inherent quality in an exchange market where investment decisions are driven by independent individuals. Market fluctuations are market corrections of inappropriate investment decisions. Hence such fluctuations could be kept under manageable limits provided investors act wisely and patiently. Look at market fluctuations as your friend rather than your enemy"