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Take Charge of Your Financial Destiny

Financial Planning. Mortgage Management. Asset Protection

What Should I Invest In?

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In the previous articles, we briefly talked about how you can measure your readiness to invest. We also talked about whether your Debt Servicing Ratio (DSR) is within the healthy range, and how being mired in debt will derail your efforts at gaining financial independence.

In this article, we shall elaborate on the various investment vehicles you can put your money in. This is, of course, dependent on your investment-readiness, and whether your DSR is in good shape.

Crisis Or Opportunity

As mentioned frequently in my previous articles in this series, the current economic condition can either be a crisis or an opportunity. As such, whether you choose to enter the markets to invest, or whether you decide to stay on the sidelines, is very much dependent on your investment readiness, risk profile, investment objective, investment horizon and budget. Bearing these qualifiers in mind, let us do an objective take of the situation.

After weeks of witnessing a continual downward trend in the stock market, the Straits Times Index (STI) has rebounded close to 9% within a week. Experts are divided on whether the rebound is merely a 'dead cat bounce' – a temporary recovery from a bear market after which the market continues to fall – or whether the market has finally bottomed out and is therefore set to recover.

Bearing in mind that the stock market is usually indicative of the state of the economy 6 to 12 months in advance, let us take a snapshot of what the equities market is telling us at the moment.

Visible Market Correction

The Price-To-Book Ratio has conventionally been used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share.

For the STI, the average Price-To-Book Ratio over the past 10 years has been about 1.7x while its lowest point in March 2009 was about 1.0x.

Current valuation puts the Price-To-Book Ratio to be about 1.25 times. Although there is a 25% gap compared to what it was during crisis time, one can infer that the downside risks of investing are lower as compared to the potential gains that one can achieve in the long-term investment horizon.

That said, what should you invest in?

Investment Instrument #1: Equity

Due to its very volatile nature, investing in equity carries with it a very high risk. And while it is true that everything that goes down must come up – especially in the equity market – following Warren Buffett's example of swiping everything of value that is offered at a discounted price is just not for everybody.

Due to the uncertainties triggered by the debt situation in Europe, the equity market is, in general, set for a roller-coaster ride. And unless there is a clear solution to how the crisis is going to pan out, volatility is here to stay.

As such, should you decide to invest in equity, the first question you should ask yourself is whether you have the risk tolerance to stomach the volatility. If your answer is an affirmative 'yes, this instrument is for you.

Objectively, the average projected Price-Earnings (PE) ratio of emerging markets is 12x, but current market valuation is set at about 8x based on 2012's projected earnings.

Hence, there is a potential upside in the future for markets to reach the projected value, provided that you have the resources and courage to ride out the waves.

Investment Instrument #2: Gold

Gold is a precious commodity. It is widely perceived as a safe haven for investors in times of uncertainty – and thus its sparkling allure – and its effectiveness as a hedge against inflation means that demand for this precious metal will continue over time.

After hitting a high of around US$1900 per ounce in September, the value of gold went to a low of US$ 1609 within a period of 1 month. Is this a sign of the end of a bull run for gold? Or is it a mark of a greater investment opportunity?
Due to its unique qualities and overall economic environment, we believe that gold has a strong potential to cross the US$2,000 mark, but against a backdrop of high volatility
One thing to note, however, is the intricate links to the value of the US dollar. The stability of the greenback – which can no longer be taken for granted in the new economic climate – must be taken into consideration before one decides to buy tonnes of gold to store in a vault.

Investment Instrument #3: Bonds

A bond is a form of debt in which you become the bank. There are many types of bonds, and some examples include sovereign bonds and high yield bonds.
Perceived to be safer than equities, bonds are not without their own risks. The main risk lies in the credit risk, with the credibility of the issuer of the bond constituting a major factor as to how risky the bond is. Typically, less credit-worthy issuers will offer a higher yield, while bonds issued by governments tend to offer a lower interest rate as they are deemed to be more stable.

Of course, the latest debt crisis has shown the world how all investment instruments, bonds included, contain the element of risk. The reputation of sovereign bonds as safe and stable investment instruments has suffered a beating as events in Europe unfold. Governments, once thought to be unlikely to default on their loans, are under intense scrutiny by global financial institutions as their ability to repay is now very much in doubt.

There are also foreign exchange risks to consider as most bond are priced in US$. The foreign exchange exposure may add or reduce the value of the bond investments depending on the movement of the foreign exchange the bonds are denominated.

That said, sovereign bonds – and bonds in general – still have a major role to play in an individual's investment portfolio. An investor, who wishes to invest in bonds, needs to understand the mechanics of credit rating, and their implications on the long-term viability of the bond concerned. On top of that, investors would also need to know the different types of bonds available, and which type they are suited for.

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Going Forward
Yes, while the investment market has not seemed favourable to long-term investors in the past couple of years due to the global financial instability, it is still vital for you to invest in order to gain financial independence. Knowing where you stand financially is the first step towards a successful investment; it helps you recognise which instrument will profit you best, according to your current financial situation.
Get in touch with the Financial Advisers from SingCapital today and we will bring you through a FREE financial health check so that you can benefit from the market recovery and make smart investment decisions for the future. You can also download our free financial worksheets at www.singcapital.com.sg/ratios so that you can assess your finances.

The road to financial independence is a long one. You need to constantly sharpen your knowledge about money and how to grow it. To be constantly updated about financial planning, mortgage management and asset protection, you can sign up for my free newsletter at my site at www.alfredchia.com.■