

The upside of the downswing

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Elevated market volatility may be driving retail investors away from shares, but fund managers are jumping in to take advantage even as the historically difficult month of October arrives.

The S&P/ASX 200 recorded its worst quarterly performance since 2008 with a 13.01 per cent slump in the three months to September 30, a period which incorporated the biggest daily swing for the index in 35 years.

That has turned “mum and dad” investors off the stockmarket, with the preference for shares as the best place to invest savings at its second-lowest level for 18 years, according to the Westpac-Melbourne Institute, and the worst may not be over if history is any guide.

The month of October has seen some of the biggest sell-offs in the history of the Australian stockmarket. Trading for the month, and the December quarter, is expected to start on a sour note on Monday morning with SPI futures tipping the S&P/ASX 200 to open 81 points lower following falls of more than 2 per cent in Europe and the US on Friday.

The economic gloom and volatility has even permeated popular culture.

Independent trader Alessio Rastani caused a sensation after appearing on BBC News last week and declaring his intent to make money in tough times: “I have a confession, which is I go to bed every night, I dream of another recession.”

Australian fund managers may not take such an extreme line, but are still doing their best to profit from the turmoil. And having cash to deploy is a key part of the strategy

Wilson Asset Management chairman Geoff Wilson believes the potential for a market crash this October sparked by an unexpected event in the euro zone cannot be taken off the table, given the fragility of market sentiment.

“There's that saying, everyone's looking for the light at the end of the tunnel, but it might actually just be the train,” he said. “The problem at the moment is no one can even see the light of the train.

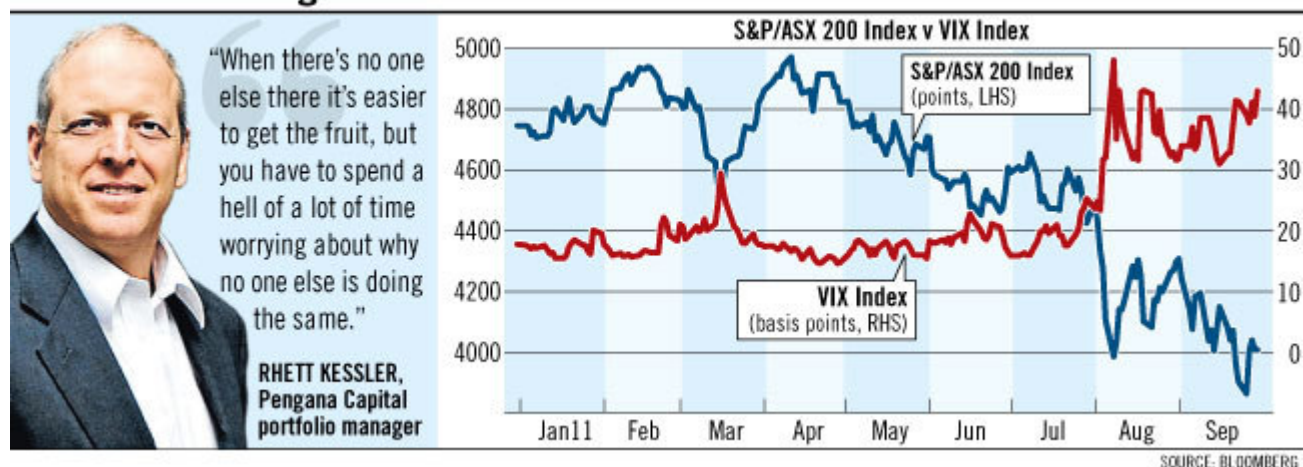
“With that pessimism there is a significant risk that we'll come to work one morning and the markets will be down 10 or 15 per cent.”

But swings like these are unmissable chances to pick up stocks at rock bottom prices, Mr Wilson said.

“When that capitulation happens, it will be one of the great buying opportunities,” he said.

Wilson's main fund is between 50 per cent and 60 per cent invested in cash.

Stomach churning



WaveStone Capital co-founder Ian Harding is also readying himself for any volatility.

“The speed of these corrections means that while it may be popular to step back and avoid, if you're not invested on the day when there's an agreed resolution to ring-fence the euro zone as an example, you might find the market rallies 8 per cent on a day and it could do the same the second day,” he said.

“You could get a year’s performance in two days. The message is maybe you need more than ever to stay the course and be invested, even though it’s very volatile.”

According to analysis by *The Australian Financial Review*, the three months to December has been the worst quarter on average since 1980, for the All Ordinaries, with an average gain of 0.95 per cent.

For the S&P/ASX 200 that same quarter is the best of the year, with an average gain of 2.89 per cent since the index’s creation in 1992.

History and impending offshore developments aside, fund managers expect a continuation of the volatility and uncertainty that marked August and September.

Pengana Capital’s Australian Equities Core Fund was one of the few to come out ahead in the wild month of August, with a 1.4 per cent return versus a 2.9 per cent fall of the sharemarket. Portfolio manager Rhett Kessler said that was a result of some brave decision making.

“We swallowed hard and we bought more,” Mr Kessler said. “All we felt happened was the market became irrational, people threw out the baby with the bathwater. Instead of freezing or running and hiding, or joining the panic – it was tough, and I must admit the guys were saying I was very white – but we stepped up to the plate and deployed quite a bit of cash.”

Mr Kessler topped up holdings in favoured stocks already in his portfolio, including Seven West Media, News Corporation, Duet Group and NIB Holdings, and sold back down when the market rebounded. The fund also established a position in Woolworths for the first time.

“I’m more bearish than most about the outlook, but I’ve never been so bullish: the opportunities it’s presenting it’s like when you’re trying to pick low-hanging fruit in an orchard, it’s very hard when everyone else is in there.

“When there’s no-one else there it’s easier to get the fruit, but you have to spend a hell of a lot of time worrying about why no one else is doing the same,” Mr Kessler said.

Mr Harding also worked to capitalise on the volatility in August.

“I feasted,” he said. His fund uses tools such as options and shorts to take advantage of the wild market moves. His Australian Equity Long/Short Fund recorded a 0.5 per cent loss in August.

“It’s hedging your bets, is what we tend to do, and it’s why on average we should do a bit better at times like this,” he said.

As the markets fell in early August, Mr Harding increased holdings in stocks in the infrastructure and utilities sectors, as well as mining services stocks, with Transurban and Campbell Brothers two favourites. He also bought into retailers OrotonGroup and Super Retail Group.

“To say we were buying retail in this environment would be surprising, but you’ve got to buy the right retailers,” he said. “It is very much stock picking in this sector.”

Although he says he is comfortable about continuing to employ options as a hedge, even Mr Harding is finding it difficult to stomach the day-to-day volatility.

“You feel as if your head is spinning. What’s occurring one day is the opposite of what’s happening the next day – the [Australian dollar] is up, the Australian dollar is down. If you have foreign translation on earnings that works one day and doesn’t work the next.

“Commodity prices are up then they crash again. There’s no trend, and to trade this market you almost need to trade it daily and that’s not what we like to do.”

But prior market swings have been worse. In 2008, in the immediate aftermath of the Lehman Brothers’ collapse, the S&P/ASX 200 recorded a fall of 12.66 per cent, and also its biggest one-day percentage fall of 8.33 per cent.

October 1987 saw a fall of 42.45 per cent, the All Ordinaries’ biggest monthly loss since at least 1980, including Black Tuesday on October 19 when the Australian market lost a quarter of its value in a single day.

Black Monday on October 28, 1929 was the date of the Wall Street crash that heralded the beginning of the Great Depression.

The Australian Financial Review

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