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Focus on valuation, not volatility

Take advantage of market gyrations for long-term success

In the last year the CBOE Volatility Index, a commonly used benchmark for market volatility, has ranged from 13.66 to 48. Often called the "investor fear gauge", the VIX measures market expectations of near-term volatility conveyed by stock index option prices. The CBOE changed their methodology in 2003 and the average has since been in the 21 range, which is slightly lower than current levels. A measure of 21 implies an expectation that the S&P500 will move up or down approximately 6.1% over the next 30-day period.

Unfortunately, investor fear has driven some to ignore the principles of valuation, reacting impulsively to negative news in general. The energy, materials, and metals and mining sectors, now into double-digit red, provide a good example. Even though many of the companies within those categories are blue chip and fundamentally intact, pessimistic investors have sold them in reaction to bad news not necessarily pertinent to the sectors.

Even junior mining markets have suffered from headline headaches. According to Canaccord Genuity analysts, speculative capital has been largely sidelined due to the constant barrage of negative news that has been feeding investor fear. The TSX Venture Index is now at 2003 levels, despite an elevated metal price environment, and analysts believe there are opportunities for selective buyers. Many junior companies took advantage of the good markets to raise cash and now possess robust balance sheets, but stock prices aren't reflecting it.

Volatility can be unsettling but, if handled correctly, it can also be a friend. For long-term investors, market turbulence opens the door to opportunity. By concentrating on valuations, they can benefit from the downward impact of emotional selling and add to existing good quality positions on dips. For those who have been sitting on the sidelines, opportunities are plentiful to build new portfolios of solid, blue chip companies.

The markets are likely to remain erratic over the near-term, so investors should consider incorporating defensiveness by buying some dividend-paying stocks. Consistent cash returns ease dependency on market price appreciation for returns and help reduce portfolio volatility. Sustaining regular dividends and having them grow are also important indicators of a company's quality.

When investing in volatile markets, dollar-cost averaging techniques are a good idea. Instead of purchasing in a single lump sum, investors ease into an acquisition by buying over a period of time. The concept works particularly well in volatile markets as it eliminates any concern of trying to time the markets and it reduces the cost base. Simply speaking, when the market is up you

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Continued from Page 1

receive fewer shares but when it's down you get more.

Panic selling can devastate a portfolio. Instead of being distracted by turbulence in the markets, investors should concentrate on their long-term goals with a well-defined investment strategy that includes rules to acquire at the right prices and rules to protect against losses. The investors with the discipline to stick with a plan, do their valuation homework, and remain cool during market cycles are best equipped to achieve their investing goals.

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