



MONEY DUE REWARDS:



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The Warning Call

For some time now, it has been our opinion that investors should be retreating into quality “blue chip” investments, and away from the more speculative end of the market. A recent warning call from the local research house Lincoln has added considerable weight to this opinion. In announcing the findings of their recently released “health of the market” report, managing director Tim Lincoln said that over half of the companies in the Australian share market are in relatively poor financial health.

Lincoln’s methodology is a form of fundamental research, which conducts detailed analysis on the financial reports of Australian listed companies each reporting season.

In applying this methodology, Lincoln found that 58% of companies in the recent reporting season fell into either the “distressed” or “marginal” categories. Before we panic and sell our portfolios, however, we should take notice of the accompanying comments. In introducing the findings, Lincoln commented that “with the mining boom, many companies have sprouted in the hope of striking it rich ... the majority of these businesses are speculative companies that are yet to generate revenues, relying on debt or capital raisings to stay afloat.”

Apart from the speculative mining companies, Lincoln’s main concern was certain highly geared alternative investment companies which will need good performance from their investment assets in order to stay afloat. This comment certainly rings true, given the announcement in late November that the locally based hedge fund manager, Absolute Capital was placed into voluntary administration. Only time will tell how this will develop, as it is presently unclear how investors in Absolute’s flagship “Yield Strategies Fund” will fare.

The good news arising from Lincoln’s report, however, was that apart from these particular sectors, the Australian market is in a very solid position. In the overall financial sector, for instance, (which has recently been sold down as a result of sub-prime concerns), they found that 68% of companies are in a strong or satisfactory financial position. This is 4% better than the result six months ago, and certainly not indicating any impending crisis.

So what does this all mean in practical terms?

In my view, it means that there is little cause for panic. Whilst returns have been disappointing in the last few months as the market has retreated, the Australian market is now valued much more reasonably than it was during its recent highs.

In this situation, some may be tempted to chase returns by investing in small, speculative mining companies, or something else which is similarly aggressive. My own opinion is that you will be better off in sticking to the high quality stocks with strong balance sheets, as these will tend to be more rewarding over the longer term, as well as creating far less worry in the meantime.

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