When bad news is good news

Money Matters

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When is bad news good news? Bad news is good news when the news is not as bad as you were expecting – and this is often true when investing in the stock market.

Over the longer term the stock market is very effective at assimilating all freely available information in determining the correct price of a specific share and/or the market as a whole. However, over the shorter term Mr Market suffers from bouts of depression (lows) followed by periods of euphoria (highs), when his ability to price a business accurately is severely compromised by his prevailing mood.

During these high and low cycles, rational investors are offered an opportunity for making money.

Markets always overshoot on the downside and again on the upside as investors get caught up in the daily noise driving the short-term price cycle. Prices disconnect entirely from the long-term underlying value of the businesses making up the market.

Financial commentators often refer to the real economy versus the financial economy, which is the value of a business (real) making up the market versus the market share price (financial), which you would expect to be the same. Wrong!

Local listed property is currently offering a perfect example of the disconnect between value and price driven by the market's overly pessimistic view of listed property, which has resulted in listed property going from investor's sweetheart to the dreaded ex...

Property is the ideal asset class to explain how the market's short-term irrational behaviour results in a disconnect between price and value. The reason for this is that most people understand the value of residential property as a bricks-and-mortar asset, which is easily valued. Any opportunity to buy your neighbour's house at a discount, compared to what it would cost you to build, is likely to be met with great interest from the street.

Listed property companies are no different, in that the underlying assets of the company are bricks-and-mortar buildings, which can be valued on a replacement cost basis no different to that of residential property. In fact, the valuation is a lot more accurate given the professionalism of the sector, which includes role-players such as architects, quantity surveyors, construction companies, professional valuers and large institutional investors such as assurers, pension funds and wealthy private investors.

Given the aforementioned, you may be surprised to hear that the average listed property company share price is trading at a 30%+ discount to the underlying net asset value (NAV) of the buildings they own.

How do you explain this, other than Mr Market's depressed mood and irrational behaviour, which has resulted in prices falling 30%+, notwithstanding the real underlying value of the properties they own? You are effectively buying your neighbour's house for a discount of 30%+, but there are no buyers!

The current negative SA sentiment has seen all asset class (equities, property and bonds) prices fall to levels that now reflect the bad news, and if I am right about Mr Market's being overly pessimistic then we can look forward to a much better 2020 simply because prices are currently too low.

Thank you for reading my column this year; all the best for the next decade! – *www.mwwealth.co.za*