Should I Buy A Stock At Its 52-Week Low?

Description

How do you know when a stock becomes cheap enough for you to buy?

I've had a few readers and friends ask me what my plans are in the current stock market climate. Inspired to start investing after reading my blog, a few have even made their virgin stock purchase, after seeing that the prices have hit their 52-week low.

While that can often be a good signal to buy, but let us also be mindful that this is not a golden, sure-win rule when it comes to the world of investing.

In a bull market where prices tend to trend upwards, then yes, the 52-week-low prices can be a good entry point. However, the tides have changed, and we're now officially in a bear market. In a bear market, prices tend to fall. It is not surprising to see prices tumbling to below their 52-week-low or even their IPO prices when the economy and general sentiment is poor. My guess as to when they will stop falling is as good as yours.

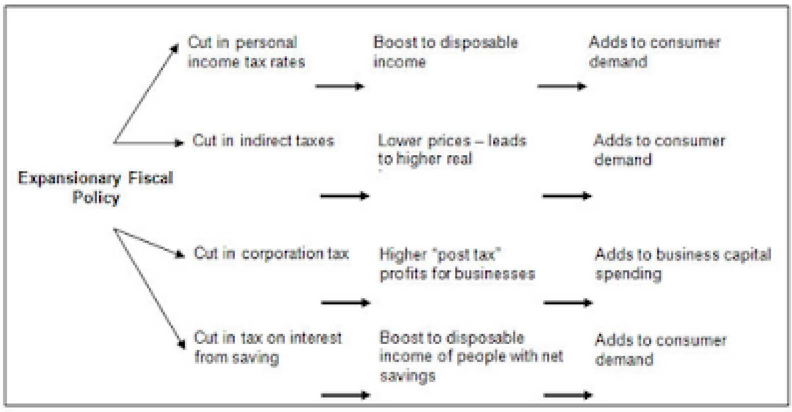
The 2008 – 2009 global financial crisis spanned over 4 quarters before slowly starting on its path towards recovery – plenty of time for investors to buy.

Countries	GDP Growth Rates (YoY)				Stock Market (month-end)		
	Q3-2008	Q4-2008	Q1-2009	Q2-2009	June-08	March-09	Change (%)
US	0.7%	-0.8%	-3.3%	-3.8%	11,350	7,608	-33.0%
Eurozone	0.6%	-1.4%	-4.9%	-4.8%	3,315	2,036	-38.6%
Japan	-0.2%	-4.3%	-8.7%	-7.2%	13,481	8,109	-39.8%
Korea	3.1%	-3.4%	-4.2%	-2.2%	1,674	1,206	-28.0%
Hong Kong	1.7%	-2.5%	-7.8%	-3.8%	22,102	13,576	-38.6%
Thailand	3.9%	-4.3%	-7.1%	-4.9%	768	431	-43.9%
Malaysia	4.7%	0.1%	-6.2%	-3.9%	1,186	872	-26.5%
Philippines	5.0%	4.5%	0.6%	1.5%	2,459	1,986	-19.2%
Taiwan	-1.0%	-8.4%	-10.1%	-7.5%	7,523	5,210	-30.7%
Singapore	0.0%	-4.3%	-9.5%	-3.5%	2,947	1,699	-42.3%
Indonesia	6.4%	5.2%	4.4%	4.0%	2,349	1,434	-39.0%

Venturing out of the stock market and into the real world, we will see businesses suffer shrinking profits, or even start going into debt. Companies start cutting jobs and retrenching staff. The danger that a business might close shop becomes very real.

With shrinking profits and revenue, companies find it difficult to repay their loans. Banks will then suffer, and be forced to cut jobs. As it is, Standard Chartered and HSBC are already among the few who have announced job cuts. The impact will be felt by other businesses as well, especially SMEs who may face rejection of loans from the banks. The whole economy will start to contract, and with such negative sentiments abound, foreign investors will start to be more wary, perhaps with some even pulling out their investments. Cash will then become king as people hold onto their money for security, lest they lose their jobs overnight. Fewer people will spend and tourism numbers will start to fall.

As the economy gets worse, the government will eventually have to step in. Here are some potential moves they might make, as they had before:



Another thing we should also consider is our term horizon when we view our investments. Using the STI as a gauge of stock market performance, if we were to study today's prices compared to over the last five years, it does seem as though now is an attractive time to buy.

However, if we broaden our view to the last 10 years, it seems as though the drop might not be anywhere near its bottom yet. Speak to investors who have been through the 2008 crisis, and many are saying that the sentiments seem to be headed towards similar grounds. Could it? I'm skeptical, but I do think the drop will continue for a while longer.

If we were to take an even *longer* perspective over the last 15 years, you'll notice that today's drop is almost insignificant compared to the bottom-lows then.

There are also various signs that the economy might still continue to contract for a little longer.

> To say the Singapore economy disappointed in the second quarter would be an understatement. It performed even worse than already-tepid expectations, contracting 4.6 per cent on a seasonally adjusted, quarter-on-quarter annualised basis.
>
> The pullback was broad-based; all three sectors – manufacturing, services and construction – posted sequential declines over the previous quarter for the first time since Q3 2001. (Source: Business Times)

If you blindly invest into a stock just based on this one reason alone, you're putting yourself into dangerous territories. When Lehman Brothers tumbled, they never recovered.

So back to the question – what is Budget Babe planning to do in today's stock market?

I'll tell you what I'm trying to NOT do: rush into buying.

I'm not buying just because a stock price has dropped to its 52-week low, since I believe it might drop even further.

For now, I'm happy to wait. While I wait, I'm keeping an eye out for resilient businesses who have demonstrated excellent track records of riding through crises. I'm adding and removing companies from my stock watchlist while reading up and analysing them.

I'm looking for undervalued businesses that are suffering from declining stock prices amidst the gloom. I'm watching out for great management who can make me confident that they'll be able to manage the company's finances well enough to not end up bankrupt if a recession should occur.

I'll be buying based on value, rather than price alone.
What about you?

With the FED's fickle decision on whether to raise interest rates or keep them stable, banks and oil companies retrenching staff, and amidst announcements that the Singapore economy is expected to slow down in the next few quarters…I'm in no hurry to buy.

I do not know when the market will recover, but based on historical cycles like we've briefly studied above, it won't be an overnight affair. I have no illusions about entering at the bottom, but I'll be content to either ride it down a little longer, or catch it on its way up before prices skyrocket again.

So don’t you worry your pretty little mind about missing the boat, and focus on getting your fundamentals right first.

With love,
Budget Babe

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