

Why this financial advisor is optimistic in the recovery of the Singapore stock market

As Asian stocks have been dropping ferociously for over a month until about a few days ago, most expect it to continue to go down. Our minds have perceived a pattern and because the pattern appears to hold, we believe that the pattern will continue to repeat itself.

Unfortunately, following our instincts can potentially lead to disastrous outcomes when it comes to making investment decisions. Many investors want to sell now at possibly the worst time as they may not have the time to study the global environment and make certain contingency plans beforehand, like how they are going to react in certain unexpected market events. When we feel that we do not understand what is going on, it is very difficult to calm our frazzled nerves. In the natural world, our instinct for fleeing danger, often before the threat materializes, will save us from many predatory dangers. However, this same instinct is usually counter-productive when it comes to pursuing better investment returns.

The purpose of this writing is to help investors better understand what is going on and so they can make more informed investment decisions during this market rout. Basically, I am optimistic of the recovery of the Singapore stock market in the coming months. Why? There is a technical and a fundamental answer.

The technical answer:

First, for many of the Asian markets including Singapore, the selling did not start after an extended bull run. In fact, market sentiment was already slightly bearish in January and February before the market rout started. Therefore the market structure, at least in China, most parts of Asia and Singapore is very different from that during the 2008 Global financial crisis when almost all stock markets just completed a 4 years bull run that took the Straits Times index, for example, to about 3900 points in late 2007.

Therefore, based on the structure of the Singapore market when the selling stampede started, it should be similar to the 2015 correction when the STI index dropped from about 3500 points to an intraday low of 2500 (29% loss). Applying the same percentage loss to the current market rout, 29% loss on 3150 points would give us a STI low of about 2236. We hit an intraday low of about 2210 points on the 23rd March.

Second, the short sellers who sold down the market cannot hold on to their short positions indefinitely. In the initial weeks of selling, the short sellers are aided by margin calls. In a normal market, there are always speculators who buy say \$3 or \$5 worth of shares with their \$1 capital through various arrangements like margin trading accounts or using futures and other instruments to boost their investment returns. Hence, when the markets dropped by 20 to 30%, these investors will be asked by their brokers or bankers to top up cash in order to hold their stock positions. This is called a margin call. Most would not be able to meet the margin call and the broker or bank would then have to forcefully sell all their stock holdings into the market, which would exacerbate the selling for a while. In other words, selling begets selling. Then, at some point, we will reach a point when all these leveraged longs are flushed out of the system, and all we have are bargain hunters who buy with no margin and can hold their positions indefinitely. This is also the point when the selling pressure climaxes, and the short sellers start closing their positions. That is the seed of the technical rebound or what we called a short covering rally.

We must never forget that the markets are full of predatory players who make a living out of having small investors for lunch. When these big speculative players are selling, they will also create negative news to discourage or delay bargain hunters and long-term investors from coming into the market. Reports will be out to explain why the market will not be rebounding anytime soon or that the economic situation will take months or longer to resolve and the like. These professionals do so well because they are the experts at tricking other investors into reaching the wrong conclusions. As such, to do well in the investment game, investors must be wary of giving in to our fleeing instinct and overcome it. Only then can they raise the probability of scoring long term gains.

The fundamental answer:

We are in a global situation where inflation is minimal or nonexistent. In this environment, the US Federal Reserve can openly go back to quantitative easing (QE4), which is now in its fourth episode. QE is essentially monetary easing at its extreme. Some countries like Japan have taken things one step further by buying equities outright instead of just buying government bonds, mortgage backed securities and corporate bonds. At the same time, the US is launching an initial USD2 trillion fiscal stimulus package. While the money is still being disseminated, discussion for a second stimulus package is already in progress

The United States, who have been sitting on the fence until early March, were forced into action when they had to implement lockdowns and measures to contain the virus spread, thus impacting both their economy and stock market. With the US taking the lead on monetary easing and fiscal stimulus, it is basically a green light for the rest of the world to do the same. Indeed, central governments around the world have all announced their respective monetary easing and fiscal stimulus measures over the past weeks to cushion the impact on their economies. The Singapore government has also announced our own S\$60 billion stimulus package (over 3 tranches) that is quite unprecedented in scale for this country.

Many US listed companies have been using their profits for stock buybacks in the past 5 years, putting them in a poor cash flow position to weather this storm. As a result, the US government must step in aggressively to rescue them with bailouts, especially the airlines, Boeing and hospitality related industries. This also gave the green light for other countries to do the same for their strategically important companies if need be.

With stabilizing infection numbers, countries like China, Korea and Japan are reopening their factories. Once the money from the US stimulus package starts flowing into the global system, things would likely normalize faster than what most people would expect.

In conclusion, the world is not coming to an end, especially for Singapore, as our listed companies are in much better financial shape than those in the US and Europe. During the good years, the Singapore government has implemented housing market cooling measures, such as more stringent loan requirements and additional stamp duties to reduce excessive speculation. Shares buyback activities in Singapore have been muted. Hence, Singapore banks and listed companies are entering this crisis with relatively healthy balance sheets. As long-term investors like Sovereign wealth funds, insurance companies and retail investors with deeper pockets continue to enter the Singapore stock market for bargains, we are likely to see more short covering rallies. So, for this advisor, the sky is blue again and I can see the rainbow just over the horizon.