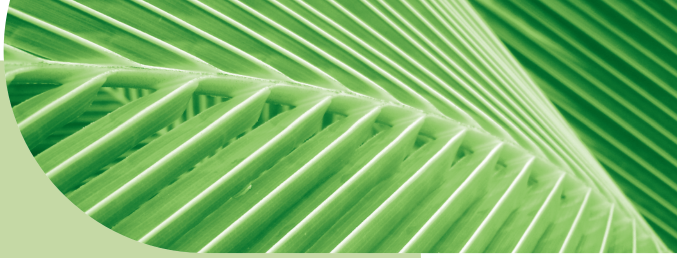

The great bargain hunt

"We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful."
Warren Buffett

It's 'sale' time

How often have you waited for the sales to buy something you've been thinking about for a while? You may have needed a new car, a fridge, or even a bigger house, but managed to hold out until the price was right. And when you eventually bought the item, it wasn't so much that it was cheap, but more that it was a good price compared to the value of the item.

We now have a similar situation with our sharemarket. In a bear market, like the one we are experiencing now, the prices of investment assets have fallen substantially. This has occurred across companies, sectors and asset classes. What's important to note is that even high quality companies, with sound business foundations and a bright future have significantly fallen in value, even when they are vastly superior to weaker companies.

That's why a bear market offers you the opportunity to buy quality assets at highly discounted prices and lock in potentially outstanding returns. Take a look at the following table. As you can see, even the companies traditionally perceived as 'blue chip' have fallen dramatically in price.

When is a good time to buy?

First of all, it is never a good idea to try to time the market. Even professionals with many years of experience don't get it right all the time. However it does make sense to consider buying when the markets are at such extraordinary low levels. Here are four good reasons why:

1. Prices have fallen too far.

In the year to end November 2008, the value of Australian shares (as measured by the ASX S&P 200) fell almost 50%. Yet compared to most economies, Australia is in good shape. Inflation is under control, unemployment is still low and the banking sector sound. Many Australian companies have become dramatically cheaper, as you saw in the table below. It's important to remember that buying quality assets cheaply doesn't just leave more room for prices to rise – it also reduces your risk because the room for prices to fall is also smaller.

Difference in opening and closing price of the top 10 stocks on the Australian Sharemarket*

Company name	Sector	Opening Price (31/10/07)	Closing Price (31/10/08)	12 mth price change	P/E Ratio	Income/ Dividend Yield
BHP Billiton Ltd	Materials	46.1	27.99	-39.28%	8.48	3.0%
Commonwealth Bank of Australia	Banks	61.5	40.3	-34.47%	9.86	8.1%
Telstra Corp Ltd	Telecommunications	4.68	4.12	-11.97%	13.29	6.9%
National Australia Bank Ltd	Banks	43.1	23.99	-44.34%	7.47	10.0%
Westpac Banking Corp	Banks	30.54	20.28	-33.60%	8.64	8.4%
Australia & New Zealand Banking Group Ltd	Banks	30.1	17.36	-42.33%	9.50	9.5%
Woolworths Ltd	Food & Staples Retailing	33.45	27.8	-16.89%	19.58	3.6%
Westfield Group	Real Estate	21.8	16.4	-24.77%	15.36	7.1%
QBE Insurance Group Ltd	Insurance	32.5	25.5	-21.54%	12.03	5.2%
Rio Tinto Ltd	Materials	110	77.6	-29.45%	3.44	4.5%

* As at 31 October 2008, S&P/ASX 200 Accumulation Index.

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2. Income returns are still attractive.

Now that share prices have fallen, the income you get from some quality Australian shares is particularly attractive. Yields of around 7% mean you're earning a return better than many high interest cash accounts. However, you also have potential capital growth to add to that income. Just as importantly, many quality Australian companies pay fully franked dividends – so the income you receive is much more tax effective than from cash.

3. Help is on the way.

In recent months we have seen Central Banks and governments around the world slash interest rates, pump more money into their economies and bail out or buy stakes in a number of large financial institutions. All these institutions are committed to fixing the crisis and using whatever measures possible to restore confidence in the global financial system. History suggests that once these measures start to gain traction, investment markets respond positively and returns bounce back.

4. Take a look at the Price to Earnings (P/E) ratio information.

The P/E ratio effectively compares the price of a share with the earnings it generates. The higher the ratio, the more you are paying for the earnings of the company, although it can also indicate that investors are optimistic about the potential of that company.

The combination of these three factors - bargain prices, attractive income returns and government support - provide a compelling reason to ignore all the negative noise and buy quality assets, but where do you start?

How to find the bargains

Senior Investment Strategist at Advance Asset Management, Felix Stephen, says that while there are a number of buying opportunities, you should accept that the volatility we have seen recently will continue for a while, so you need to be patient and to hold your nerve.

If you're ready to get out your wallet, then Felix says that a good place to start is with large stocks, as they tend to outperform smaller companies in uncertain times. "In the medium term, Australian insurance, telecoms and healthcare companies should generate steady returns as should companies that sell consumer necessities, said Felix. "Companies that sell discretionary or luxury goods, property trusts, industrial companies and transport and infrastructure businesses may struggle in a slowing economy where high debt levels are a handicap."

Felix also believes that the recovery in the Australian share market will be led by banking and financial stocks. "While weaknesses in the global financial sector is one of the root causes of the current crisis, I'm confident that Australian financial companies have been dramatically oversold and now that all the potential negatives about these companies are priced in, many offer exceptionally attractive tax effective income," said Felix.

Managed funds

Managed funds offer diversification and specialisation across companies, sectors and asset classes. Over the next few years the investment environment will offer significant opportunity but it will be volatile. To take advantages of these opportunities fund managers need to 'rotate' quickly between companies and between different market sectors and geographical regions. That's why investors need managers who are experienced and nimble, and, above all expert stock pickers – able to pick the individual companies likely to prosper in changeable market and economic conditions.

Heading out to shop

Yes, there's a lot to consider and it can get a bit confusing. Buying bargains is hard work, particularly when markets are volatile, and you may have to be brave with some of your decisions. As always, you need to consider your own risk profile and investment objectives.

Only a financial adviser can provide you with tailored solutions to meet your individual situation and objectives.

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