



# INVESTING IN OVERVALUED MARKETS? 投资估值偏高的市场?



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Are markets out of touch with reality? For some markets – especially China – the short answer is an unequivocal ‘yes’. But elsewhere, it is not quite so obvious.

Markets around the world are at or approaching record highs. This in itself is not necessarily a cause for concern. It is easy to forget that markets do trend upwards over time and so new highs will inevitably be set. Indeed, on a number of factors, major markets are quite reasonably valued. Profits are high and inflation, whilst on the increase, does not seem to be bubbling over. Consumer spending remains strong and countries such as Germany and Japan continue to recover, which means that the world is less dependent upon sustained US consumer spending to keep things afloat.

In China, on the other hand, the Shanghai Composite in the last 2 years has risen substantially more (291.46%) than did the NASDAQ (188.95%) in the two years leading up to the Tech Crash of 2000. Stories of bubble behaviour abound.

The risk of a sharp correction is substantial. If Chinese markets do crash, panic may well be the latest Chinese export to flood developed markets. When China dropped on February 27th, the reverberations were felt around the world. China’s rapid recovery and awesome continued rise (up 49% from the close on February 27th to May 24th) has helped calm

and then boost global markets. But a sharp and prolonged fall could lead to far more severe losses globally.

So how does an investor balance the potential upside from world markets against the possibility of a potential China-inspired panic?

Most media hype focuses on the performance of market indices. However, stock market indices are merely a representation of the performance of the shares of companies listed on the index. The index may be very high, but this doesn’t mean that all companies represented on that particular index must be overvalued.

The key is, therefore, careful stock selection. But how do you assess whether a company’s shares are good value?

Companies own assets such as cash, land and property, all of which can be readily valued. By valuing the assets of a company, and then subtracting any debt owed by the company, the careful investor can work out a company’s net asset value (also called the intrinsic value). This provides a very conservative valuation which can then be compared with a company’s current stock market value to assess whether the company is over or undervalued. If a company is trading close to (or below) its intrinsic value it is likely to be undervalued by the market. This provides significant opportunities for the shrewd investor. Undervalued companies tend

to recover their value over time and be less prone to dramatic price falls. Increased upside and reduced downside leads to successful investments!

## EXAMPLE – LATECOERE (LAT. PA).

This French company specializes in aircraft fuselage manufacture. It is profitable, has a 3-year backlog of orders, pays a near 3% dividend but, incredibly, has a market value of less than its intrinsic value!

Historically, uncovering and investing in a globally diversified portfolio of such companies has dramatically outperformed the stock market, whilst protecting investors from substantial losses.

World stock markets today range from the mildly expensive to the prohibitively overvalued. But careful stock selection using intrinsic value as a guide can still provide tremendous upside, whilst protecting you from being caught up in market hype.