The Stan Clark Financial Team's

PERSPECTIVES

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Investing

Adding just that little bit of momentum

By Stan Clark - Senior Investment Advisor and Michael Chu - Associate Investment Advisor

As we've discussed before, our team uses several rules-based strategies to help you achieve higher returns with lower risk when investing in stocks. These strategies cover the whole spectrum of investing, from *value* to *momentum*.

Value investing is buying stocks that are well priced compared to their business fundamentals. For example, stocks that have a low-price-to-earnings, or a high-dividend yield (meaning a low price compared to their dividends).

There are a number of reasons why value stocks exist. Basically companies are cheap because they are neglected or out-of-favour. The principle of the value investing approach is that, in the short term, investor psychology often pushes prices well below the true long-term value. By selecting neglected or out-of-favour stocks, shrewd investors can benefit from the broader market's impulses and mistakes.

Momentum investing, on the other hand, involves looking for companies where things are improving and/or surprising the market. People are slow to change deeply held convictions. So, a company that surprises once is likely to surprise again, which typically leads to even more price increases.

There are a lot of value companies out there. But sometimes these stocks can stay cheap – or worse, get even cheaper. This is what we call a value trap: companies that seem to be at a good price compared to their fundamentals, only to have their fundamentals then deteriorate. It's a fine line between a good value company and a value trap. Unfortunately, this fine line can often only be discerned in hindsight. To help avoid the value trap, we do things a little differently. We add a momentum component.

A momentum component exists in all of our strategies, even in our more value-oriented ones. At first this might seem counter-intuitive. Shouldn't we have at least one pure-value strategy to reap the full benefits of value investing? It's a good question.

We've done a lot of studies on this. We've found that adding a bit of momentum is well worth it, while staying within the virtues of value investing. By adding that little bit of a momentum component, we get ourselves into companies that may not be the absolute cheapest – but have signs that things are turning around. Signs such as a company announcing higher-than-expected earnings, or analysts increasing their estimates.

We also look for companies whose stock price is increasing more than others. This implies something has occurred that the market did not anticipate. Studies show companies that surprise, especially those with growing earnings, tend to do better than average for the next six to 12 months.

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Stan Clark is First Vice-President, Portfolio Manager and Senior Investment Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

To learn more about CIBC Wood Gundy, The Stan Clark Financial Team and the many ways we can help manage your wealth, please contact us by phone or by email as listed below.

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