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IN THIS ISSUE

The investment universe is vast and there are many factors to consider, which is why it is advisable to engage with an experienced, qualified advisor who will utilise the funds of the world's best fund managers to construct portfolios suited to the investor's personal financial goals and risk profile for optimum returns.

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LOOKING AT PE RATIOS, NOT THE ONLY INVESTMENT INDICATOR

By André Basson, Financial Advisor and head of Brenthurst Val de Vie office

Many investors use PE ratios to decide about a share is a good buy. For most, a low PE translates into a good investment. This is not necessarily the case. PE ratios are often misunderstood and are not the only metric to use when deciding.

“P” stands for price which is measured by the current market price at which the company trades on a stock exchange. “E” stands for earnings and is measured by future or historic net earnings – in short income less expenses. A lot of emphasis is often put on income generation, but it is important to take a closer look at expenses.

Certain expenses are just the normal “run of the mill” kind which keeps the wheels going. Items like taxes, electricity costs, etc. Other costs can create long term value but are still accounted for as “expenses” in the company’s books. Examples include marketing (building a strong brand), research and development (creating new products or enhancing existing technology).

These are great expenses to spend on but will lead to lower net earnings in the short term and therefore higher PE ratios. This is one of the reasons some of the best companies in the world continuously trade at higher PE’s. As they continue to increase expenses, the company grows over the long term and the market (investors) rewards them by being willing to pay a higher price for it. Examples include Facebook and Microsoft, to name a few.

On the other hand, there are “capital heavy” companies such as mining or industrial companies, which will spend a lot of money on capital projects such building a new mine or factory. This kind of expense is “capital expenditure” and does not form part of the “income statement”.

It does not form part of normal expenses and do not have an immediate impact on the PE value. It is therefore very common to find mining stocks trade at lower PE valuations.

It is therefore important to look at other indicators and information to make a well-informed decision.
BELOW ADDITIONAL RATIOS CAN BE CONSIDERED:

- **ROIC (RETURN ON INVESTED CAPITAL):**
How effective does management grow capital that is invested within the company?
- **FCF YIELD:** Does the company have a strong cash flow generating ability?
- **DEBT LEVELS AND INTEREST COVER:** Are debt levels healthy and can the company service debt?
This is important in a global market flushed with a lot of cheap debt.
- **INNOVATION AND GROWTH:** Will the company grow, adapt and be relevant in the next decade?
What new technology is being developed? These factors are also qualitative and require in depth knowledge of economics, company management and future trends.

At the moment companies with the best fundamentals are found on international markets. That does not mean investors must ignore local opportunities but should not invest in such opportunities simply because they are cheap. The same applies when buying a house, there is a reason a great home in the best neighbourhood is expensive.

With the growing number of online platforms now available, it has become much easier for investors to invest directly in shares of their choice, and many are pursuing this investment route. However, it is advisable to consult an advisor that works with established fund managers who have proven research methods to find the best opportunities in global markets. They look at a suite of metrics of which PE ratios is only one, and their metrics often point to including stocks that mostly trade at higher PE values.

The investment universe is vast and there are many factors to consider, which is why it is advisable to engage with an experienced, qualified advisor who will utilise the funds of the world's best fund managers to construct portfolios suited to the investor's personal financial goals and risk profile for optimum returns.

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