Buy & Hold : An Intelligent Strategy?

We have witnessed deteriorating economic fundamentals across the globe resulting in the slow down of global GDP This coupled with high international oil and commodity prices produced a dampening effect on the consumer confidence in the U.S. This consumer confidence level will negatively impact the export-oriented growth of the Asian economies. These factors resulted in the exit of large international fund managers from the emerging equity markets. The emerging markets of China, India, Vietnam and Pakistan are some of such examples. These emerging markets have declined by over 40% from their peak level in just a few months. The investors need to question the traditional strategies of "Buy & Hold" and "Investment Diversification".

We covered the Investment Diversification in the previous report. Today we have to analyze the long-term capital appreciation strategy of "Buy & Hold". Does it actually work in an emerging market? The answer is Yes, as long as the inherent risk is understood. It has been proven through empirical research that market risk of an asset decreases as its holding period increases. Thus long-term investors should adopt a passive indexing strategy to increase return over investment horizon.

Let's compare China & India with Pakistan. The Shanghai SSE composite Index has declined by 64% from its peak in almost eight months but it is still up by 106% as compared to the levels of 3 years ago. The Bombay BSE Sensex has declined by almost 32% from its peak of 21,206 points in almost seven months but is indicating a positive return of 87% from the level of 3 years ago. The Karachi KSE-100 index has witnessed a decline of over 40% from its peak but is indicating an 18% gain when compared to the level of index attained 3 years ago.

We witness similar trends in the Nikkei, Hang Seng, Straits Times, Taiwan Weighted and Vietnam equity markets. Similar trends can be witnessed in the European and American equity markets due to the sub-prime credit problems leading to a global financial mayhem.

The long-term comparison when plotted over 3 and 5 years indicates further gains and growth thus leading to the validity of the "Buy & Hold" strategy. Now it is imperative for the investors to understand the risk associated with these investments over long run. Here the investment diversification rule comes in handy which can be achieved with the right balance of various asset classes in the portfolio.

The investors are encouraged to study the long-term capital appreciation trend of equity funds in the mature economies. The trend clearly corroborates the "Buy & Hold" strategy in good equity mutual funds with proper diversification in several asset classes and an active portfolio management.

FMR: Aug 08