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rise financial

The perils of short-term trading

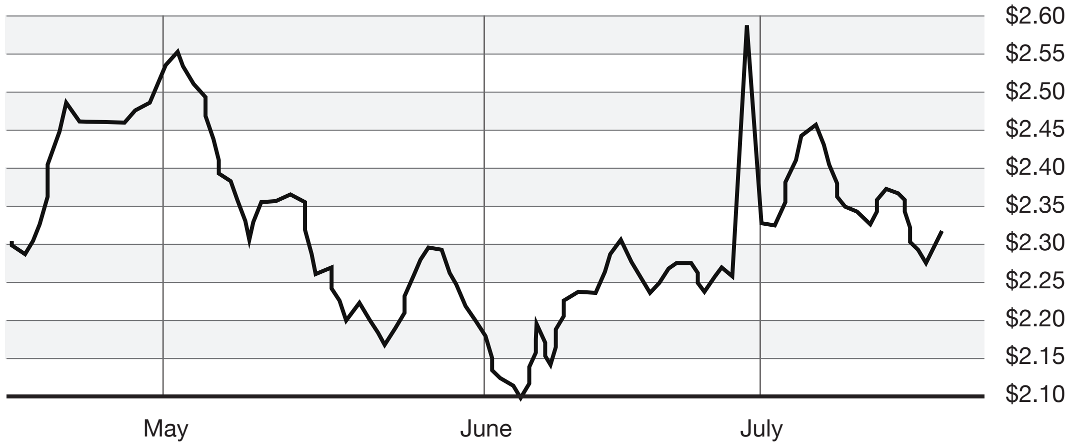
Snapshot

It was Friday 29 June 2012, the last trading day of the financial year, when department store group David Jones revealed it had received a $1.65 billion takeover offer. The market immediately went into overdrive, pushing up the price of David Jones shares by almost 20 per cent.

Then, over the weekend, doubts set in about the credibility of this offer from an unknown British outfit called EB Private Equity. The British corporate suitor was later unmasked as not much more than a website, but by then serious damage had been done.

The graph shows both the spike in the share price and just how quickly expectation or greed can turn into despair.

David Jones (DJS) share price (close) over three months to 19 July 2012



source: www.asx.com.au

When the market opened on the following Monday, David Jones' share price fell by 17.5 per cent to close to where it was before news of the offer broke. David Jones announced the offer had been withdrawn and its shares were placed in a trading halt. The next day, the Australian Securities and Investments Commission (ASIC) announced it had launched an inquiry into "potential issues regarding disclosure and trading in David Jones stock".

Snapshot

Speculators who bought David Jones shares at the height of the buying frenzy were left bruised while sellers were smiling. But in the midst of all this sound and fury, the fundamental value of the David Jones business had not changed.

What are the rules?

The case of the phantom David Jones bid raises serious questions for company directors and market regulators, and especially for investors.

Under the continuous disclosure rules, listed companies must immediately notify the Australian Securities Exchange (ASX) if there is any information that is likely to affect their share price. The ASX makes this information publicly available on its website so all investors have access to the same information.

With the advantage of hindsight, some market commentators questioned the decision by David Jones' board to announce the takeover offer before it had checked the bidder's *bona fides*. While continuous disclosure is designed to keep the market informed, in this case the information was not just incomplete but raised more questions than it answered.

Other commentators argued the company should have requested an immediate trading halt on its shares until it could provide shareholders with all the information they needed to make informed decisions about their investment. A market fuelled by gossip and speculation increases the likelihood investors will make poor decisions in the heat of the moment.

A takeover offer typically pushes up the share price of the target company, so the timing of the bid just as the financial year was closing off, raises the possibility of deliberate market manipulation. ASIC is now examining potential issues regarding disclosure of the bid and trading in David Jones shares.

But even if there is wrongdoing for ASIC or other authorities to uncover, it is likely that people who lost money in the mayhem will have to wear most, if not all of their losses.

Lessons for investors

There are important lessons for all investors in this David Jones episode.

One of the most important is to know and appreciate the difference between a company's share price and the value of its business. A second is to have an investment plan that works for you, one that lets you focus on the long term so you can avoid 'noise' in the market .

Legendary share market investor, Benjamin Graham, famously said that daily stock market activity is not a weighing machine on which the value of a business is recorded, but a voting machine where countless individuals buy and sell shares based on a mixture of reason and emotion.

It is only when you understand the true or intrinsic value of a company that you can tell if the market price is temporarily too high or too low.

History shows us excessive trading doesn't consistently produce better returns compared to that of a more passive long-term strategy. We also know short-term trading can prove a real distraction for people who have neither the time nor expertise required to crunch the numbers.

The best way to make money out of shares and sleep at night is to stick to your long-term plan, buy quality stocks and be patient. In the long run, the market will recognise the true value of a company and will price it accordingly, and that is where long-term investors become winners.

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