



Fisher Funds

Investor Education Centre

*Making investing enjoyable, understandable
and profitable...*

Should investors start at the bottom or top?

15/08/10

Top-down and bottom-up are two very different ways of looking at stocks.

Both are legitimate methods, but right now, top-down has the upper hand as investors focus more on big macro issues than what is happening at company level.

The best description I have read of top-down versus bottom-up was in a book called *The Research Driven Investor* by Timothy Hayes.

The author described the market as a giant mountain.

Bottom-up investors are like hikers and climbers who start at the base of the mountain. Their main focus is on individual companies – the equivalent of the rock formations and terrain directly in front of them.

The top-down investors on the other hand, focus well above the mountain's peak at the general conditions. They consider the economic weather patterns such as credit conditions, consumer confidence and other sweeping trends to decide what to invest in.

In prosperous times, bottom-up investors can more or less ignore the top-down conditions, just as mountain climbers can feel more relaxed when the weather is warm and the sun is shining.

But when there are gale-force winds and thunder and lightning, investors have to think carefully about what is happening at the top of the mountain. Difficult conditions could result in an avalanche or lightning strike which could ruin even the very best investment portfolio.

One of the reasons that share markets are so volatile and difficult to read right now is that bottom-up investors are seeing quite different things to top-down investors.

With each company profit result released, bottom-up investors are finding reasons to be reasonably positive about the future. However top-down analysts are seeing a much darker picture with worrying economic clouds preventing a clear view of what lies ahead.

Top-down analysts have been proven right over the past few months. Company profit results have been completely overshadowed by concerns about macro issues such as unemployment and housing sales. But there will come a point when investors are prepared to overlook macro concerns because the news at company level is good enough to encourage them to buy, irrespective of the view from above.

Of course the ideal investment is one that appeals to top-down and bottom-up investors alike. Ten or fifteen years ago you had companies like Intel and Cisco that appealed to bottom-up investors because they had a reasonable valuation, consistent management and strong fundamentals.

The top-down investors also liked them because they could see the Internet boom coming, and knew that as people bought more computers and spent more time on the Internet, these companies would benefit disproportionately.



Fisher Funds

Investor Education Centre

*Making investing enjoyable, understandable
and profitable...*

I can think of a number of companies that look good to me as a bottom-up investor but that are also well positioned for big macro trends such as an ageing population, the Westernisation of emerging economies, and the increasing demand for alternative energy.

There is no single approach to investing that works every time. Finding stocks that score well on several counts should allow us to enjoy the market aspect, whether from atop the mountain or from ground up.

Making investing enjoyable, understandable and profitable...