



Cheap shares are scarce

Of the many companies **Richard Beddard** has analysed since his December column, only three: Quadnetics, Waterman and Alumasc make it into the Thrifty 30 portfolio

There are a number of reasons I was choosier at the end of last year with additions to the Thrifty 30 portfolio. First, many companies choose the end of the calendar year as their financial year end, which means there was a dearth of reports to refer to as the rush of annual reports happens in the first four months of the new year. So with fewer companies to choose from, perhaps the quality suffers, but by the time you read this that shouldn't be a problem.

Second, cheap shares are scarcer. The FTSE All-Share index closed the year about 50 per cent higher than its March lows, which makes me yearn for those days of panic again.

Currently, the average long-term price/earnings ratio of UK shares is about 14. That's not expensive. Two years ago the p/e was more like 20 (in March, it was just eight), but it means there are many companies that are too pricey for a thrifty portfolio.

I can afford to be choosy too. Having added 16 companies, the majority of



An Alumasc 'green roof' at Bishop's Square, London

berths in the Thrifty 30 are full. I'd only want to fill them all if the market was very cheap and that opportunity has gone for now. Keeping some cash will reduce losses if share prices crash again and give me the firepower to buy cheap companies. It means sacrificing some profit if the market goes up from here, but in the long term the Thrifty 30 will do better if I behave contra-cyclically – buying on the lows, in other words.

Our trio joining the in-crowd

Quadnetics makes and markets surveillance equipment such as CCTV cameras, video recorders and the software and hardware that controls and links them to other systems such as alarms. In the 1990s it was a struggling conglomerate, but it shed its aerospace and engineering interests. However, after a promising couple of years, growth has stalled, which is something its new chief executive hopes to put right.

Alumasc is a collection of companies that make building materials for big developments and housebuilders. It has a wide product range, from solar shields

Richard Beddard (richard.beddard@iii.co.uk) is editor of Interactive Investor and a keen private investor. He writes about companies on the Interactive Investor blog.

More Thrifty information

Thrifty 30: <http://blog.iii.co.uk/about-the-thrifty-30/>

In:

Quadnetics: <http://blog.iii.co.uk/tag/qdg/>

Alumasc: <http://blog.iii.co.uk/tag/alu/>

Waterman: <http://blog.iii.co.uk/tag/wtm/>

Out:

Glisten: <http://blog.iii.co.uk/tag/gli/>

Porvair: <http://blog.iii.co.uk/tag/prv/>

J Smart & Co: <http://blog.iii.co.uk/tag/smj/>

Wolseley: <http://blog.iii.co.uk/tag/wos/>

St Ives: <http://blog.iii.co.uk/tag/siv/>

and 'green roofs' made from growing plants, to mundane manhole covers and toilet cubicles. Not surprisingly, scaffolding sales and other premium building products have been hit by recession, but its more exotic sustainable energy management category grew. Diversity seems to be its strength.

Civil engineer Waterman helped rebuild post-war Britain and develop the City of London. More recently, it has clung on to the coat-tails of globalisation, going wherever there's a construction project to manage, design or plan. As much as it's grown through these building booms, it's also cut back sharply during the contractions that followed. This time is no different and Waterman, to a greater extent than Alumasc and Quadnetics, has cut staff and restructured in the recession.

All three companies look cheap. The priciest is Quadnetics, which costs 12 times earnings averaged over 10 years. The other two are outright bargains with Waterman, for example, costing just four times earnings. However, it is, perhaps, the riskiest because of its debt; a black mark it shares with most of the companies I rejected. It also expects to write off some of the money it's owed or has invested in deferred or cancelled building projects.

Although I'll keep adding shares during 2010, I'll be even more judicious about it.



Key stats The market p/e

Just as we can compare the price of a company's shares to its profits or earnings (per share), we can compare the price of a stock market index to the profits of all the companies represented by it to establish whether shares are cheap or expensive.

Since the 10-year average smooths out temporary declines in profits during recessions, and temporarily enhanced earnings during booms, the resulting price/earnings ratio is a more dependable measure than a p/e ratio based on a single year's profits.

Robert Shiller, an American professor, pioneered the 'cyclically adjusted price/earnings ratio' for the US stock market going back as far as 1880.

My more modest attempt to chart the cyclically adjusted p/e ratio for UK shares starts in 2007.

See: <http://blog.iii.co.uk/state-of-the-market/>