Why Stocks become Undervalued

Why Stocks become Undervalued

- Benjamin Graham argued that an under valued stock is priced at a minimum of 30% below its intrinsic value
- Assuming that the Efficient Market Hypothesis is not valid there are some obvious reasons why a stock might be under valued

Why Stocks become Undervalued

- Investor behaviour, as we suggested in the previous lecture is not logical
- When markets are rising they buy, based on a fear of missing out on future profits
- However when the market turns and its falls, there is no rationality to their decision to sell, again it is based on fear - not wanting to make greater losses
- When this happens, this behaviour only reinforces the positive or negative trend

Why Stocks become Undervalued

- When investors become over optimistic, they buy stocks at prices well above their intrinsic value, in the belief that they will keep going up
- As well know too well, this is not the case and when the bubbles burst (and they always do) the share prices fall irrationally further below their intrinsic value

Why Stocks become Undervalued

- While investors hear lots of news about popular or very large stocks, Apple for example, many firms get little publicity and operate under the radar, out of the glare of investor attention
- These may drift and their share price not keep up with the development (inefficient markets) and so may offer great under valued investment opportunities

Why Stocks become Undervalued

- Bad news or bad press can lead to a sell off in a firms shares without the fundamentals of the stocks intrinsic value changing
- An opportunity for the value investor to step in

Why Stocks become Undervalued

- Cyclicality or seasonality may affect a stock and negatively impact its share price
- If you are taking a long view on the stock, this may temporarily depress the stock price (buying opportunity) but make little difference in the long term

Why Stocks become Undervalued

- When working on your intrinsic valuations you should be aware of these issues and their potential impact on the market value of the company’s stock

Why Stocks become Undervalued