

*The*  
*Money*  
*Gyaan*

*A collection of essays to enhance  
your financial quotient*

## Outsmart your brain's chemical locha

We human beings are highly emotional creatures. Many of our actions cannot be explained in terms of logic and rationality. Emotions play a very powerful role in our decision making. Even though they may not be prudent choices, often our feelings make us quite helpless.

This is evident in our investments too. It is more particularly true when it comes to equity, where the market movements are highly dynamic and dramatic. And these erratic market movements cause fear, anxiety, greed, exhilaration etc.

When these powerful emotions are at play, it would be asking for too much for people to remain calm and take rational decisions. Instead, it would be better to accept the reality of emotions and their overpowering influence; and design our investments such that the impact of emotions is minimal.

### *Buy Low and Sell High*

This logic is, of course, very easy to understand. Yet, it is equally, if not more, difficult to implement.

When the markets are crashing, it would require Herculean efforts to go and buy shares even though they may be becoming cheaper day by day. Why? Fear, of course!! Similarly, in a bull market it would impossible to keep away from buying, though the shares are becoming expensive. Greed, what else!!

But this is exactly the opposite of what we should actually be doing.

This is where SIPs come to our rescue. Once we make a commitment and hand over the post-dated cheques to the MFs for the next 12 months, our job is done. Then our investment happens automatically every month, irrespective of what the markets are doing. When the markets are down, we get more units and when markets are up we get lesser units. And this is precisely what rationality suggests us to do.

Another strategy would be 'rebalancing'. Suppose you start with 75:25 equity-debt asset allocation of your portfolio. Now, irrespective of market movements, rebalance your portfolio every six months. If equity is down/debt is up, sell debt & buy equity; if debt is down/equity is up, sell equity & buy debt.

By automating our investment process, we keep emotions out of our investment decisions.

### *Predicting the markets*

Another common human emotion is trying to guess the future. Thus we try to forecast the market directions and take appropriate buy/sell decisions.

Despite the fact that there is no evidence of anyone consistently making money by timing the markets, we simply cannot get over this addiction to prediction. One may be lucky a few times, but on the whole it is more of a losing proposition.

Again SIP comes to our rescue. It keeps us away from predicting the market movements and instead forces us to stick to the time-tested disciplined investing, which sooner or later will reward us suitably.

### *The gambling instinct*

There is a gambling trait in all of us. We may automate our investments thru' SIP. Yet, our gambling instincts are going to make us restless. And in this restlessness, it is quite possible that we may close our SIPs and exit at the wrong time.

Therefore, instead of trying to curb it, let your gambling instincts try their luck – but with only small portion of your corpus. Put 90-95% of your money into SIPs. With the rest 5-10% you can play in the F&O market or buy penny stocks or do whatever you fancy. As such, even if you lose this amount – which in all probability you will – your bulk of the investment is not affected. It may hurt you emotionally, but financially you would still be secure.

### *Holding on to losers*

Pick up any portfolio and you will find many dud stocks. People have aversion to losing money. Therefore, they do not sell a stock if it is going down. They hope against hope to at least recover their original investment. This is quite natural. But if the stock is of a weak company, such hopes are meaningless.

Therefore, except for your blue-chip stocks, give standing instructions to your broker to sell all other stocks if they depreciate by say 10-15%. Don't let him call you for confirmation or listen to you to hold on in case you make any call. Such instructions should be irrevocable.

*Don't let the chemical-induced emotions, induce you into making wrong decisions. Get smarter than your brains.*

## Who is getting rich – you or your broker?

Frequent buying and selling of stocks/MFs is very common. Amongst the many misconceptions/myths prevalent, one is that you should be an active trader if you want to make money from equity markets. Nothing could be far from truth.

‘Active’ does not mean actively buying and selling - but active in being knowledgeable about the economy/markets; active in researching stocks; active in tracking markets and active also about understanding global influences.

So why do people actively churn their portfolio?

### *Lack of discipline*

The stock markets are generally looked upon as a get-rich-quick machine. In fact, given the almost secular run-up in the markets during 2004-2007, people even started using it as an ATM - buy a share in the morning, encash it in the afternoon and go for a party in the evening.

Therefore, most investors do not exhibit either the discipline or long-term strategy in their investment decisions. They are chasing quick returns. Consequently, they buy/sell so often that they churn their portfolio many times over. Needless to mention that this short-term focus is extremely risky!

Another common manifestation of lack of discipline is timing the markets. It is taking the easy way out. Despite being fully aware that predicting the markets is simply impossible, people do not hesitate in speculating about the market directions.

And to top it all, they use all kinds of theories to rationalize their so-called predictions. If only life were so easy, we would all be Warren Buffetts.

### *Lack of patience*

The moment we buy a stock, we expect it to double soon. We will call our broker 2-3 times a day or opt for SMS feeds. After reaching home, we will first check the prices on the stock tickers being displayed by many TV channels 24-hrs a day. If we have a MF, we will check its' NAV in the papers first thing in the morning or create a portfolio on some website and check it everyday.

If there are no significant gains happening in our stock/MF, while some other stocks/MF are moving, we get impatient and switch out to other stocks/top-ranking funds. And this story repeats itself every day; day after day.

Fortunes of businesses do not usually change overnight. They are not as volatile as the stock markets and they take time to grow. So it is quite unreasonable to expect your investment to double in quick time, and that too just after you bought it.

### *Lack of right advice*

Of course a part of the blame, for an investor frequently churning his portfolio, does fall on his broker/advisor too.

We have seen many MF advisors in the past asking their clients to sell some of their existing funds and invest in the upcoming NFOs. More often than not, this was done purely out of their vested interest to earn more commissions.

They were playing on the investors' ignorance, who were misled into believing that a fund at Rs.10 NAV was cheaper and better. Fortunately, SEBI has been able to put stop to this mal-practice.

Similarly, many brokers and PMS companies, do advice their clients to move in and out of stocks on a regular basis. Again, the primary motivation is their brokerage income and not the client's interests.

Remember, you may or may not make more money by churning your portfolio; but your broker/advisor will always make money. Therefore, the more you churn the more is the broker's/advisor's income.

Since the motivation to buy and sell comes from the reasons, which are inherently wrong, too much churning usually proves counterproductive.

At the end of the day, you generally end-up only adding to your costs without any commensurate benefit in the returns and hence eating into your overall profits. There could be costs in terms of STT, short-term capital gains tax, entry/exit loads, brokerages on buying & selling, etc. While they appear to be small, over time they just keep on accumulating.

Of course, not churning your portfolio at all is also bad, as you need to regularly exit the underperforming/overvalued investments. You need to book profits and cut losses at appropriate times.

Therefore, it is important to strike the right balance. This is possible only if your buy/sell decisions are based on sound reasons and not because of some of the irrational reasons discussed earlier. Thorough research, keeping a watchful eye on the markets, setting-up proper stop-loss and profit targets, etc. will help you to arrive at correct buy/sell decisions and make your churning a profitable exercise - for you too.

PREVIEW

## 66666 in Twenty20 = Rs.1 crore

It was a great moment for India and the Indian cricket to lift the T20 World Cup again after a gap of 24 years. We all would have enjoyed the moment when Misbah's shot landed in Sreesanth's hand. I am sure we will savour this moment for years to come.

And, of course, we also cannot forget the eventful over from Chris Broad in an earlier match, in which Yuvraj Singh dispatched each of the 6 balls sailing over the boundary rope for 6 mighty sixes. And for this remarkable achievement, BCCI had awarded Rs.1 crore to Yuvraj.

Yes, that the equation of Yuvraj Singh's crore – 6 sixes in an over in a Twenty20 match.

It may interest you to note that we can do the similar thing with our money. Our equation would look something like this.

Rs.6666 p.m., increasing 6% every year, @6% p.a. returns, 20 years = Rs.0.5 crore.

If we invest Rs.6666 every month, increase it every year by 6% and invest it all in a safe instrument which gives 6% p.a. returns, in 20 years we would have accumulated Rs.0.5 crores.

Not good enough to match Yuvraj's crore? Well, that's because we are assuming a risk free return of 6%. Whereas Yuvraj took lot of risk for each of his shots! And he also took a lot of risk with his career. Just imagine if he had failed! With so many new players trying to get in, his position was definitely not safe.

OK, so let's assume that you too take some risk and try to target 12% p.a. returns thru' a suitable mix of debt and equity instruments. This, on a 20-year horizon, is a very reasonable return expectation. This will give you your Rs.1 crore.

However, good shot selection is important. Or else you might just get a single or two; or maybe even get out. Similarly, good investment selection is important. Or else you might make very low returns (as can happen in insurance policies) or even lose money (as can happen with penny stocks).

Besides this, I am sure that another issue would be bothering you – 20 years! That's too long a period to wait to become a crorepati, you would say. I want to be crorepati today!!

Well, unfortunately this is possible only with a lottery ticket or may be an inheritance. And, in either case, you would have to be amongst the extremely lucky few. For a vast majority of us, there is no short-cut. (And even if one does make easy money, more often than not, it goes away easily too).

By the way, do you think Yuvraj was lucky? Or that he made a crore in just 1 over? If you think so, then you are totally wrong.

We see only the glorious moments on TV and think how lucky Yuvraj was to get Rs.1 crore for just a few minutes of effort. But we fail to see his 15-20 years of hard work. We fail to see his 15-20 years of discipline. We fail to see his 15-20 years of patience. We fail to see his moments of trials and tribulations. That moment of his glory, which you saw on the TV, was a result of 15-20 years of hard-work, discipline, patience and commitment.

You too would have to similarly sweat it out for 20 years to get to your crore. You would have to show same discipline, same hard-work and same patience as Yuvraj. There are no short-cuts in life.

We always hear about Yuvrajs, Amitabhs, Shahruks, Sachins, Ambanis, Tatas, Narayanmurthys & many others earning crores of rupees and feel envious. We always wish to have the same kind of money, prestige and popularity. But are we willing to put in the same of kind of effort? Are we willing to take the same kind of risk? Are we willing to rough it out? No, we usually lie in the comfort of our sofa and hope for miracles.

Well, the choice is entirely yours. The world is full of opportunities. There are a million gold mines out there. All you have to do is to just get up and get going and going and going - till you find your pot of gold.

## The misleading Guaranteed NAV plans

As you would be aware, a few months back the Insurance Regulatory Authority of India (IRDA) announced new guidelines for the ULIPs. These guidelines put a lot of restrictions on the insurance/agents and also removed a host of customer-unfriendly provisions in the earlier ULIPs.

Since the agents and insurance companies have been the worst affected by these changes, they have lost a lot of enthusiasm to sell ULIPs.

However, the insurance companies are at it again. If one door is closed, they have found another one.

Playing upon the fears of the investors, after the major crash of 2008 and minor crashes thereafter, they are now aggressively marketing the so-called Guaranteed Highest NAV plans.

To put it in simple terms, on maturity they will pay you the highest NAV achieved at any time during the policy term. Thus you are protected from the market volatilities.

However, again the sales pitch is highly misleading.

Suppose the highest NAV was Rs.100 and on maturity it is only Rs.50. It is but common sense that the insurance companies may have to close shop if they have to bear this huge shortfall. Now, no company will launch a scheme where it can go bust. Besides, even the regulator will not approve any such scheme. So are they telling a lie? No, naturally they aren't.

But they aren't telling the whole truth too! So where's the catch?

The catch is that these schemes will be more or less debt schemes. They will have little or no equity in it. Since returns from debt are steady, it is quite feasible to give guaranteed highest NAV returns without the risk of going bankrupt.

The sales pitch, however, does not clarify this point. People are being misled into believing that they will get equity-kind of returns WITH NO DOWNSIDE, which is simply impossible.

And debt, as you all know, will give single digit returns. Further not only do these plans have a higher cost element vis-à-vis the normal investment products, but also an additional guarantee cost. So it is simply not possible for these plans to yield decent returns even matching the bank FDs.

Moreover, you are stuck with a debt product for 10 years.

Therefore, all in all, these are highly avoidable schemes. One can make more returns from the normal PPF, NSC, KVP and debt MF types of schemes. [In fact, given that these are around 10-year products, even normal equity schemes may deliver much better returns (as investment period increase, the probability of making loss in equity reduces)].

Unfortunately, however, given the low level of financial literacy in India, lakhs of people will put crores of rupees in these schemes and then regret later.

## **Euphoria! Mayhem! Recovery! What next?**

It has been a roller-coaster ride on the equity markets since last 5-7 years. And what a ride it has been!

From around 3000 Sensex levels in May 2003 the markets doubled to 6000 in mere 7-8 months by Jan 2004. With BJP losing power in May 2004, the markets were down to 4500 – a 25% drop in just 4-5 months. But within 6 months or so the markets were back in business and the Sensex again touched 6000 even before the year 2004 was over.

Thereafter it was almost a one-way journey right upto May 2006, when the markets hit the 12,000 mark. A sharp correction saw the markets crash to 9000 in Jun 2006. But we again saw an equally quick U-turn and a secular rise once again with markets crossing the 21,000 mark by Jan 2008.

Then we had the historic and precipitous drop which saw Sensex fall from 21000 to 8600 by Mar 2009. But yet again, within a year the market recovered most of the lost ground and has now stabilized around 17,500-18,500 levels.

A large section of the investors today joined the party only after 2003-04 and they are feeling uneasy witnessing all these sharp ups and downs. Of course, volatility is not something new. But the near-vertical ups and downs are unnerving even the old-timers in this business.

Undoubtedly, therefore, the question on everyone's mind is 'What next?'

To find out the answer, first cut out all the noise and clutter around you and go back to the basics; because 90% of the people around you are as clueless as you. If you ask 10 people, you will get 10 different answers. So when you let the facts speak for themselves, you will have a better chance of removing the ambiguities and getting the right answer.

**Fact No.1 :** Equity market is NOT a lottery ticket that you have to depend on luck to hit the jackpot. This is so because every share has a true fundamental value based on the performance of the company.

**Fact No.2 :** In short term, it may be possible for shares prices to be widely different from their intrinsic value. The irrational exuberance and excessive pessimism of the market is known to one and all.

**Fact No.3 :** In the long-run the share prices will ALWAYS tend towards their true value based on the profitability and growth potential of the company.

**Fact No.4 :** Whether US goes in the recession or not; whether the sub-prime problem creates more losses or not; whether India's growth rate slows down or not, India's economic growth rate will still be comparatively amongst the highest in the world alongwith China.

**Fact No.5 :** Unless we have some serious calamity or political crises or some very poor monetary/fiscal policies, we may continue to see a 7-7.5%+ growth rates over the next 5-10 years.

**Fact No.6 :** If the economy continues to grow at such a healthy rate, it has to reflect in the corporate performance as well. If that be so, the share prices must rise sooner or later to catch up with the fundamentals. This may take time or it may not, but it has to happen.

If we keep the above facts in mind, the perspective clearly emerges that despite the volatilities that the short-term factors may cause, the long-term outlook for India still remains quite positive.

And if India remains amongst the top economies, foreign money also has to flow in. Even if the unfounded fears of economic downturn do come out to be true, some day economy will come up again. It is a cycle after all.

So the first thing is not to panic. If we have invested in good companies/MFs, we need to just stick to it. In fact, we should be adding to our portfolio if we find good bargains (and there are quite a few of them around).

Let's say an *i10*, which costs about Rs.5 lakhs, is being offered for Rs.7 lakhs. Will you buy it? NO. But suppose the offer price is Rs.3 lakhs? DEFINITELY YES!!

I bet people do not follow the same logic with their shares. If it were so, why was everyone investing when the PE ratios had reached ridiculous levels – in many cases into triple digits? And now when the PE multiples have become reasonable, if not downright attractive, no one seems to be interested in buying. What an irony!

So overcome your pessimism. The basic rules of markets and investing will never change. Only problem is people never stick to it. And when they lose money, they blame the markets; whereas the blame truly lies with them only.

Needless to add what has been said innumerable times in the past - be patient and be disciplined – and one shall be suitably rewarded.

PREVIEW