EQUITY INVESTMENT

What is more lethal for your portfolio...

Fear of having missed out on the bull run or the greed of squeezing more from markets

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More often than not, investing decisions are based on fear and greed, rather than knowledge and wisdom. As markets rise and fall, an investor swings between exhilaration and panic. This may lead to poor decision making as they (investors) may fail to read market cues correctly. Let us see how can one identify whether a decision is directed by fear or greed.

Fear-driven decisions

Often, when the market falls, investors step away, that is, they stop their investments. But subsequently, when markets rise to reasonably good levels, investors again begin to show interest. But by then anxiety has already crept in and the worry in investors' mind is, "Did I miss out on a bull run?"

Fear makes one look at the market as a lost opportunity when in reality there may now be room for it to do better. How then do we know if there is scope for good returns? We figure that out by placing emphasis on valuation parameters: price-to-earnings (P/E) ratios, instead of looking at market levels and timing our entry. P/E ratios help gauge how expensive a market is. For example, the table illustrates how investors gather when the market is doing spectacularly and scatter when the mood is gloomy. *(See table)*

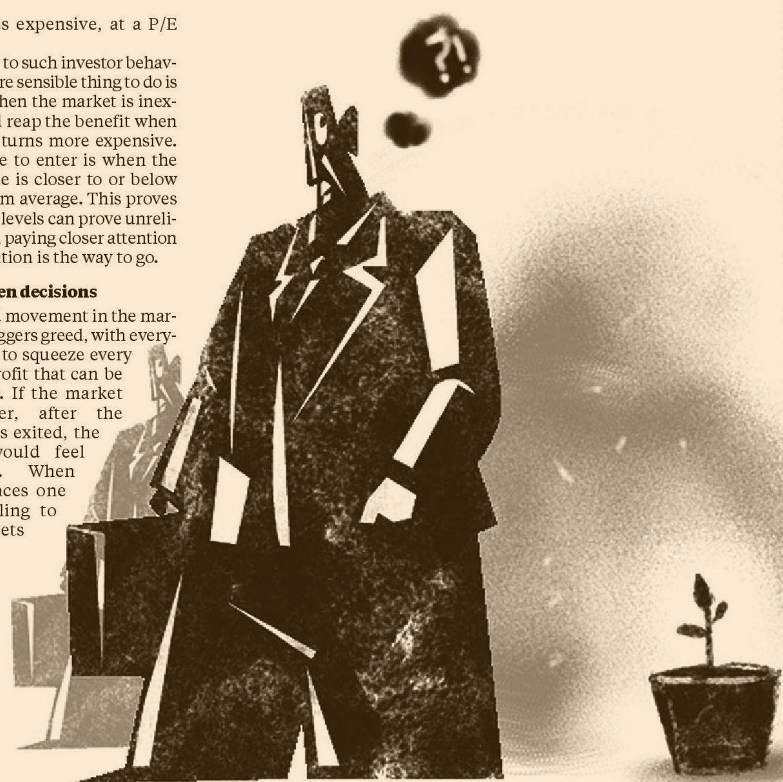
If we look at this in terms of P/E levels, we see that, in FY 2008-09, when the P/E valuation was as high as 20.4x, net mobilisation stood at ₹52,701 crore. In FY 2009-10, after the 2008 crisis hit, the market dropped, and the P/E valuation fell to 12.1x. The market then saw net mobilisation of ₹4,084 crore. That net mobilisation indicates that investors flocked in when the market was expensive at a P/E ratio of 20.4x, and pulled out when the market was less expensive, at a P/E of 12.1x.

Contrary to such investor behaviour, the more sensible thing to do is to step in when the market is inexpensive and reap the benefit when the market turns more expensive. A good time to enter is when the P/E multiple is closer to or below the long-term average. This proves that market levels can prove unreliable. Hence, paying closer attention to P/E valuation is the way to go.

Greed-driven decisions

The upward movement in the market often triggers greed, with everyone hoping to squeeze every potential profit that can be sniffed out. If the market does better, after the investor has exited, the investor would feel remorseful. When greed surfaces one tends to cling to certain assets for far longer than necessary. To combat the temptation of holding on to select assets for over long, it is important to look at the larger picture– strategic asset allocation.

The common thread that runs through both is the irresistible temptation to time the market. Picking which is better is like deciding which of the two is more noble a sin



An investor needs to maintain his/her strategic asset allocation at all times. How does this help? This ensures that an investor does not rely on short-term benefits, which could endanger long-term ones. The idea behind asset allocation being "strategic" is that it is crafted to meet one's objectives. Any deviation from such a strategy could mean compromising one's goals or risk appetite.

For example, consider a strategic asset allocation of 50 per cent equity and 50 per cent debt, and investing in an impulsive market: 1st April 2007 to 31st March 2010. Had an investor re-balanced his/her portfolio half-yearly, it would have generated a 12.26 per cent CAGR. Failure to re-balance a portfolio would have distorted the asset allocation to generate a 9.97 per cent CAGR over the same period. This demonstrates how sticking to one strategic asset allocation can counter an unpredictable market.

P/E RATIOS VIS-A-VIS INVESTMENTS

Financial year	BSE Sensex (March-end)	Average forward P/E	Equity net sales (₹cr)	Absolute 1-year	2-year CAGR
2008-09	15,644	20.4	52,701	-38.00%	6.00%
2009-10	9,709	12.1	4,084	81.00%	42.00%

Source: Average forward P/E (monthly average P/E for the year) – Bloomberg; Equity net sales – AMFI

Fear v/s greed

Fear of having missed out on a bull run may prevent one from entering the market, while the greed of squeezing out more from the enticing market may compel one to hold longer than necessary. The common thread that runs through both is the irresistible temptation to time the market. Picking which is better is like deciding which of the two is more noble a sin. While fear considers when to jump in to make a quick buck, greed refrains from pulling out in an attempt to make a little more. Yet if one were to pick between the two 'evils', an investor is better off in the market than out of it. Investors first need to overcome the fear of entering the market. Greed can later be tackled.

To avoid being caught in either of these two scenarios, investors must keep in mind a few time-tested tips.

- *Invest in the right asset classes*

The quality of asset allocation establishes the future of one's wealth. It is therefore imperative that one invest in the right asset classes to amplify the probability of meeting one's goals.

- *Hold on for the long term*

The desire to win short-term jackpots has claimed the money of several investors. Thus, the focus needs to shift to substantially increasing the likelihood of making positive returns by staying invested for the long-term

- *Re-align your strategic asset allocation from time to time.*

Allowing one's asset allocation to stray from its original strategy is synonymous with giving up on one's goals. Periodically fine-tuning one's allocation ensures that the portfolio is always in line with one's goals. Wisdom asserts that the magic word is not "the right time"; it's "long time." Time in the market, not timing the market, is what generates good returns. Continuing to be invested wisely for prolonged period reduces, in fact, almost eliminates, the possibility of negative returns.

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