Chapter 1: Market Memoirs

(Take a peek into the market's diary...)

Article 1: To trade or not to trade

(Solving the dilemma of a newcomer to the stock market who is tempted to trade)

I was having a peaceful nap when I was rudely woken up?

I got up rubbing my eyes to hear many cries of "July 2, 2001"

July 2? I strained my ears to listen to people who have always been under my shade expressing concerns. It looked like they saw no future and had no option to do anything about it. They sure were lamenting!

I cupped my ears to hear well. They feared that no 'badla' and introduction of options and futures was meant to destroy the market, ie cut my roots! Surprisingly, they were not shedding a tear for me but were worried about the fact that they will no longer have the shade! How self-centred can one get!

I opened my eyes wide enough to look at who were actually wailing. They all were fat people who had merely played under my shade and at times hurt my roots. In fact, they made use of a creeper 'badla' to climb up and dance on my slender branches that were meant to further my growth.

But let me assure I have been around for a very long time. I have seen many people come under my shade, and fruits have grown every season on my branches.

Oh! Before you confuse me for a giant mango tree and wonder what am I doing here in Sharekhan School, let me introduce myself. I am the "Indian stock market"

I am over 200 years old and possibly the oldest one in Asia. My initial history is obscure. The English (East India Company), who came to India to trade, planted the seeds of my future. By 1840 (a good 160 years back), there were registered companies trading in the market with half a dozen recognised brokers. By 1860, there were 60 brokers!

In fact, the first stock market mania in India happened then. The civil war broke out in the US and India was the only supplier of cotton to the world! By 1861, there were 250 brokers J. Guess what happened next? The civil war ended in 1865 and there was a big slump in the market. The Bank of Bombay share, which traded at a princely price of Rs2,850 crashed to Rs87 in no time.

I survived that mania and God knows how many more after that?

After the slump, the brokers decided to regulate themselves. As a first step, they moved in together to stay as a flock on one street--that street is today known as "Dalal Street". Year 1899 is when the Bombay Stock Exchange was formed.

You must have come here hoping to learn something and I have been just rambling. Without much ado, here are some facts and figures that I shall use to make a few points to you today. Here is a comparison of statistics in 1946, the earliest available statistic and statistics for 1995, the latest available. I know 1995 is still outdated but it helps make my point.

	1946	2000	CAGR

Capital of listed Companies (Nominal) (Rs. Crs)	279	59583	11.32%
Capital of listed Companies (adj Inflation) (Rs. crs)	4431	59583	5.33%
Market Value of Capital listed (Nominal) (Rs. crs)	970	478121	13.20%
Mkt Value of Capital listed (adj inflation) (Rs. crs)	15919	478121	7.04%
No. of listed companies	1125	8593	4.15%
Capital per listed Co. (Nominal) (Rs. lakhs)	25	693	6.89%
Capital per listed co. (adj Infl) (Rs. lakhs)	407	693	1.07%
Market Value per listed co. (Nominal) (Rs. lakhs)	86	5564	8.69%
Market Value per listed co. (adj inflation) (Rs. lakhs)	1415	5564	2.78%

The number of listed companies is up eight times in 50 years. Inflation adjusted for these fifty years, the capital raised is up 13 times while the market capitalisation is up a good 30 times.

Isn't it a sign that I have done very well over these years serving corporates that hope to raise capital for their businesses as well as investors who invest in these companies?

Of course, in the interim period, most of the originally listed stocks have all disappeared, but the fact that investors who managed to pick the survivors every time would have made 8.69% per annum return or 2.78% inflation adjusted return.

That's not much, you would say? Well, if you had invested Rs1,000 in 1946 it would have been Rs65,000 after fifty years. But Rs1,000 fifty years back is not equal to Rs1,000 today. In fact, what Rs1,000 was worth fifty years back would be worth Rs16,000 today. Even then, it would have quadrupled.

Can you think of any other way you could have done this over the last fifty years when this country saw an average inflation of 6%? Apart from the last ten years, India ever since Independence followed a socialistic path that stunted my prosperity.

True that there is no guarantee that any institution that has survived for over 200 years will necessarily survive the next 200. After all, even the great civilisations that we read about in our history books came to an end. Why else would they be in a history book? J

But I have been changing. Derivatives are another way that will help me to serve my purpose better. It has worked in stock markets across. Mind you, it is nothing new here too. We used to have 'Joota' and 'Phatak' here.

What has changed is that there is a lot more science now. Black & Scholes worked out a formula for pricing 'options' that is complex sure but in the world of technology you have calculators that just fetch the price for you.

After all, I did exist before people knew 'P/E' and I existed before people discovered 'PEG' too. How long has it been since Ben Graham worked out a classic style of investing or a Phil Fisher evolved his own style of investing?

These are all examples of investors evolving to make better investing decisions that help them create wealth for themselves on a consistent basis.

We all need to evolve. I am changing for the better. Earlier, investors had to invest and manage the uncertainty of their investments in the same place. Spotting the dilemma of the investor, speculators came up. Initially, it was a symbiotic relationship till the balance broke. Obviously, with little at stake compared to an investor, the speculator made merry.

The investors scurried for cover. But when the investors started disappearing, without them the speculators had to feed on each other and thus their race started dwindling. After all, the investors who were the very basis of their existence disappeared. L

They offered to move to the neighbouring compound in order to allow the investors to thrive and thus was born the derivatives market. In case you are wondering who does the balancing act now, well they are called arbitrageurs.

I am evolving! Are you? If you have no intentions, please don't wail either. Just pack your bags and don't waste my time.

You are keen to evolve? I am very happy and you are my friend. Come let us prosper together.

I rest my case.

Article 2: Janus faced volatility

(Understanding how investors and traders come to terms with volatility.)

Here is the essence of the wisdom that we have picked up along our journey to this stage.

Stock prices are predictable with larger degree of certainty in the long term

Traders attempt to profit from 'sentiment' and investors profit from the 'fundamentals' of the business

Hence 'trading' and 'investing' need diametrically opposite approaches, attitudes and horizons

Let us begin the next leg of our journey by answering a simple question.

As an investor, which stock would you rather own?

- Stock ABC Ltd. that goes up 100% in year 1, declines 40% in year 2, gains 100% in year 3 and drops 50% in year 4.

- Stock XYZ Ltd. that advances 5% in year 1, rises 5% in year 2, gains 5% in year 3 and increases another 5% in year 4.

Doesn't ABC Ltd. seem the right stock to invest? After all, a simplistic calculation of average returns every year for ABC Ltd works out to 27.5% (200% minus 90% divided by 4). Where as for XYZ Ltd. the average annual returns works out to 5%.

Most of us who wish to be investors make these simplistic calculations and decisions to chase

big winners at times without realizing that there is a big risk we take as investors.

Let us assume we invest Rs100 in ABC Ltd. After year 1, the investment goes up to Rs 200. In year 2, it will drop to Rs120 (declines 40%). Year 3 is a good year and the investment grows to Rs 240 (gains 100%). In year 4, the investment in ABC Ltd is worth Rs120 (50% in year 4).

Imagine, you invested Rs 100 in XYZ Ltd. Year 1, it would be worth Rs105. Year 2- Rs110.25, year 3-Rs115.75 and at the end of year 4, you would have made Rs121.5. This way you actually end up making more money than ABC Ltd.

Would it change if you were a trader?

Obviously, yes! Imagine buying ABC Ltd for Rs100 and selling at Rs200 in year 1. Selling short Rs200 worth of ABC in year 2 to make a cool profit of Rs80 (a decline of 40% on Rs200). Then in year 3, buy Rs 280 worth of ABC Ltd and sell it to realize Rs560. Short ABC Ltd in year 4 to make a profit of Rs280. Wow, a cool profit of Rs740.

Whereas in XYZ Ltd, you as a trader would have still made a profit of Rs21.5 L

The learning: Volatility in stock prices presents an opportunity to a trader whereas it is a threat to an investor. Another fact that demonstrates that trading and investing are poles apart.

A short break in our journey to spare a moment understanding how the investor grapples with the threat of volatility. Of course, stretching the horizon of investment helps an investor turn a blind eye to market storms.

There are three active ways of handling volatility. Asset allocation or in other words the way you distribute your wealth between stocks, real estate, gold,fixed income securities (like bonds, deposits) and cash. Portfolio diversification helps handle risk too. Steady investing or spreading investments over a longer time frame is another way of smooth sailing in turbulent market waters.

Time now to prepare a ground to move on?

You are new to the market. You are standing at a junction. You now have these options.

At the primary level, you can either be a trader or an investor.

At the secondary level, you can pick between a stock like ABC Ltd or XYZ Ltd.

Earlier, we have worked out that, as a trader you could have a maximum profit of Rs740 if you were trading **ABC Ltd.** If you were trading **XYZ Ltd.**, you would have earned Rs21.50.

Alternatively, as an investor you would have raked in profits of Rs20 in ABC Ltd and Rs21.5 in XYZ Ltd.

We have represented the profits as a matrix below.

	ABC Ltd.	**XYZ Ltd.**
Investor	20	21.5
Trader	740	21.5

Clearly, the maximum profit of Rs740 trading in a volatile stock like ABC Ltd stands out as the best option. Most new comers to the market make these mental calculations and jump at the option of being a trader in ABC Ltd. J

Is it the right choice?

As Alice would ask `Would you tell me which road leads out of the wood?'

The cardinal mistake most newcomers to the market make is that they assume they are taking the risks of an investor in XYZ Ltd. when they trade in ABC Ltd. in search of the maximum returns. However, we are all a lot more knowledgeable now.

We know how the Janus faced volatility means two different things to the investor and the trader. We also learnt at the beginning of the journey that unpredictable sentiment rules stock prices in the short run whereas predictable business earnings dictates prices in the long run.

Many of you would have already resolved the dilemma. Next time we shall address this in greater detail.

Article 3: My sojourns above 4000

(FIIs, blasts, bull, crashes, MFs... the market's memoirs of its journey beyond 4K. Are there si...)

Manmohan Singh opened the gate, Big Bull did the rest

The first large-scale bull market witnessed on the Indian bourses was single-handedly masterminded by the Big Bull. Manmohan Singh set the agenda for opening up the economy after India barely managed to hold out on a balance of payment crisis. The new open economy provided great potential for businesses and the stock markets rejoiced. The big bull ended up being a messiah of the stock market. He took the market to dizzy heights, levels at which the valuations were discounting the next three years? earnings! In the run-up to its high of 4467, the Sensex appreciated 109.5% in just three months. The bubble had to burst and it did, with the break-out of the scam. Nobody had bothered to query the Big Bull?s source of money! Until an intrepid journalist discovered that he was siphoning money from the banking system! The rest is history.

April 22, 1992: Sensex gains 109.5%

Top 5	% gain	Bottom 5	% gain
ICICI	271.40	Tata Power	29.20
Tata Chem	238.80	Novartis	46.70
Castrol	190.80	Glaxo	51.00
Reliance	190.00	Colgate	58.80
BSES	175.20M	Guj Ambuja	61.50

(Gains/losses for quarter leading to the date)

12th September 1994: After more than two years I broke my record to touch 4643

FIIs rush in where angels fear to tread

The country?s stock markets saw a new breed of animal grazing in its fields ?the Foreign Institutional Investor (FII, 3 letters that struck awe!) The FIIs rushed in herd-like fashion, confident of taking on the Indian Investor still reeling under the aftermath of the great scam. How mistaken they were. Smelling them coming from a mile away, the great Indian Investors sheared the whole field and sold it to them at a premium!

The rise and fall of mutual funds in India

The period witnessed mutual funds coming of age in India with private players entering the field and the biggest FII ?Morgan Stanley setting up its close-ended fund. The units of this scheme were so sought after that people were willing to pay Rs17 for a unit of face value Rs10 at market levels of 4000! Subsequently, the mutual fund industry saw a setback and has managed to regain currency only in the last one year.

Vultures prospered?

The huge inflows of funds from FIIs inspired a lot of companies to raise fresh equity capital. While the better ones raised capital at exorbitant premia through the GDR route, others did it in the domestic market. Meanwhile, many more created companies to make money for themselves! The investment bankers and merchant bankers (two species of vultures distinguished from the other by the presence of neck-tie) thrived as they tirelessly pulled IPOs out of their hats, (not a mandatory garment) exploiting the free price regime for public issues! In the end, there was so much fresh paper available that supply far exceeded demand and the fairy tale ended.

12th Sept 1994: Sensex gains 11.7%

Top 5	**% gain**	**Bottom 5**	**% gain**
Novartis	48.30	SBI	11.80
M&M	36.50	Infosys	26.20
Hindalco	33.70	HPCL	06.60
Gujarat Ambuja	28.50	Tata Power	05.40
BHEL	30.30	HLL	04.10

(Gains/losses for quarter leading to the date)

6th August 1997: I could only manage 4605

Chidambaram?s dream budget brings in more cheer

The economy had been under a credit squeeze as the incumbent Government in ?94 raised interest rates to tackle inflation. Then came Deve Gowda and Chidambaram who unveiled the dream budget on 28th February 1997 that ushered in fiscal reforms, relaxation of direct tax rates, et al. This budget unleashed the animal spirits of the economy and the market responded with a spirited rally.

FIIs, FIs, Locals and everybody alike united

The rally this time around gained the support of all and sundry. Everybody believed in the dreams portrayed by Chidambaram. The corporates? bottom lines also swelled because of a significant drop in tax rates. This overwhelming bullishness led to a secular uptrend all the way past 4000. However, as the market approached its all-time high, many of the smarter ones woke from the reverie and realised that the dream still remained a dream. Reality caught up with the market and it was just a matter of time before collective bullishness reversed?

6th August 1997: Sensex gains 19.6%

Top 5	**% gain**	**Bottom 5**	**% gain**
Castrol	81.30	Indian Hotels	08.60
Infosys	61.10	BSES	01.80
ICICI	61.70	TELCO	5.11
Glaxo	47.00	Bajaj Auto	05.20
HLL	44.50	Tata Power	03.10

(Gains/losses for quarter leading to the date)

13th July 1999: I did it! I hit 4678!

Asian crisis, Pokhran blasts, political uncertainty?Give me a break

The intervening period between 1997 and now has been the most tumultuous period in the

history of this country. A bloating Government fiscal deficit made it impossible for additional Government spending to boost the economy. Private investment was not very forthcoming in infrastructure due to lack of clarity on the policy front. The Asian tigers in the meantime got reduced to domestic cats. A combination of all these factors stifled domestic economic growth and choked Indian corporates. To add to these woes, demand failed to catch up with excess capacities created during the early nineties. UTI was on the brink of collapse, raising the spectre of a complete financial system failure. The new BJP government proved completely inept at handling this crisis. As a result, the stock markets crashed to all time low in December ?98, with erstwhile blue chips trading below book value and a majority trading below their face value.

How low can low get

The dismal state of the economy had forced fresh capital allocations to enter Software, Pharma and FMCG stocks as they stood insulated from the vagaries of the economy. In December ?98, a lot of frustrated investors dumped economy-linked stocks to switch to these fancied sectors. This shift not only gave the market a much-needed fillip, but also created a gross imbalance between valuations for the Software, Pharma, FMCG sectors and the economy-sensitive sectors. The cyclicals and commodity stocks started trading at ridiculously low valuations.

Enter FIIs, flush with funds

The BJP Government unveiled a better budget. In the meantime, the Indian corporate houses that were reeling under the duress of recession reworked and restructured their businesses by getting out of unviable businesses. Cost-cutting exercises assumed tremendous importance as the companies battled to survive. The Asian economies had recovered too, boosting commodity prices. The cheap prices attracted FIIs who were flush with funds. Market sentiment deteriorated after the fall of BJP government and it gave the FIIs a great opportunity to buy. Ever since, the market has never looked back, although the local sentiment is still bearish! Hence, the locals have largely been bystanders, as the market whizzed past them to touch an all time high at 4678. For once, the FIIs had the upper hand.

13th July 1999: Sensex gains 26.3%

Top 5	**% gain**	**Bottom 5**	**% gain**
Grasim	178.00	Glaxo	07.50
ICICI	121.60	Bajaj Auto	07.80
TISCO	90.60	Castrol	03.10
TELCO	97.90	Nestle	03.10
Hindalco	100.10	BSES	08.80

(Gains/losses for quarter leading to the date)

Looking back

The market has come a long way

Compared to the market in 1992, today?s market is far more transparent, much more liquid, and more efficient. Unlike in the past, dematerialisation of shares has banished the nightmares of bad deliveries, forged transfer deeds and duplicate shares. In short, buying and selling of shares has become more reliable and hassle free.

Corporates have realised the importance of creating shareholder value and the long-term benefits it holds for them. A majority of them have mended their ways to adopt stringent accounting policies and become more transparent to share holders.

Investors have learned to separate the wheat from the chaff. Today?s investor does not hesitate to punish errant corporates. Investors have become more savvy in valuing firms for their capital efficiency, growth prospects. They have learned to use various fora like the AGMs and the Press to voice their concerns. Intermediaries of the stock market have become more service oriented. Brokers, unlike in the past, go out of their way to woo clients and retain them with better service in terms of research reports, stock ideas and efficient back-office handling. Mutual Funds have polished their investing skills to consistently perform better, in order to ensure better collections. Investment bankers have helped corporates restructure to unleash shareholder value. The Government and its associated functionaries? @#@# dinosaurs. How do we get them to change?

Article 4: Indian equities: Generation Next

(We took a peek into the future. Generation Next, a global market...)

uly 20th 1999, 6:00 am: A dealer in a leading Indian brokerage house wakes up and, even before reaching out to switch off his alarm, rushes to look at the closing quote of ?Infy? on NASDAQ. One look at the screen and he dashes to call up his client. ?Infy? crashed $25 yesterday??barely does he finish completing his sentence than pat comes the response: ?Oh Shit! Dump 10,000 Infosys on BSE?.

A new era has begun
Welcome to the new era in Indian stock markets, when stocks listed on a local stock exchange trade on another bourse on foreign soil. The trend, which had started with GDRs being issued by Indian companies, has culminated in ADRs getting listed on NASDAQ?which has a very high retail investor following. Technically, an FII can trade these stocks round the clock! Factoring in new information into the stock price by the hour. Of course, it puts the domestic guys at a disadvantage, but not for long.

New vistas opened with a mere listing across the globe

How does a mere listing across the globe impact the existing scenario?

1. For starters, the company gets compared with a global basket of companies in its sector. In short, gone are the days when one could compare Infosys with just NIIT or Satyam; it will now get benchmarked with the likes of IBM, Microsoft!

2. A global listing helps the company to raise capital efficiently and effortlessly.

3. In an era where it is becoming imperative for companies to locate their operations across the globe so as to reach customers globally at the lowest cost and with the best quality, a $ listing offers an excellent currency for acquisitions.

4. Managements will be forced to shape up and accept global best practices.

5. Indian companies will get an opportunity to establish a global presence, attract the best talent and retain them by offering ESOPs in countries of their choice.

Flip side

1. Traders can never sleep! Stocks will effectively be traded round the clock.

2. Volatility levels will increase as news gets factored in round the clock.

3. Indian markets will be indirectly exposed to the vagaries of global markets

A peek into the future
July 20th 2009: A dealer in a local brokerage house answers a phone to listen to a client ask him in Gujarati to look at scrip code BS g012 and buy 1000 shares at market. The dealer punches in the code and Microsoft?s (the original one!) name flashes on the screen?

At the same time, in a tea garden in Assam, a man is staring at the screen of his internet broker (you know who), keying in a query: ?Should I buy Infosys or Microsoft??
'Infosys', says the broker promptly.

The man executes the order?
Half way across the globe, on a sunny day in Chicago, a floor trader in CBOT futures exchange is bidding for September 2009 futures contract of BSE at (hold your breath) 20,000!

Article 5: Indian elections: marked to market

(There has to be a strong divide between the markets and the political happenings...)

This decade has been path breaking for India in many ways. Our country partially opened the doors of its economy to start with, and the winds of globalisation swept in to open the doors further. Our software talent gained tremendous recognition. Socially too, the country came out of its closet. The music channels MTV and Channel V have changed the attitudes of the youth. The older folks have kept pace too in their own way.

On the other hand, the political situation has been fairly volatile. We are having our fourth general elections in less than 10 years! (And we were taught in our civics classes that the country goes to polls once every five years). New parties have emerged on the political scene while the existing ones have split beyond recognition! (Hopefully the limited imagination of political parties in finding political symbols will put an upper limit on the number of parties!) The country has seen four different prime ministers from three different parties! We decided to revisit the elections in this decade, tracking the market movements during the period to catch any trends that will give us a better insight into the days ahead of us.

Elections and the Market

May 1991

V.P. Singh?s government, that came to power in 1989, wrecked havoc on the country. The Gulf war added to our woes. Chandrashekar, who stepped in after toppling V. P. Singh, was no better. The ensuing seat wrangling led to the Government being toppled and the country going to polls. Rajiv Gandhi was assassinated while campaigning on 21st May 1999. As a result, the Congress got swept to power with a marginal majority.

The country had the combination of an astute politician at the mantle with an economic scholar running the affairs of the country. The country had pledged its gold to tide over a balance of payment crisis. The IMF and the World Bank insisted on the country embarking on a ?stabilisation? and ?structural reforms? programme. Manmohan Singh had no choice but to open up the economy, inviting foreign capital to meet the growing capital and forex requirements of the country.

Initially, the market was unruffled by the political drama, with the Sensex trading around 1280. As the elections approached, the market staged a minor rally to 1360 levels - what everybody now refers to as the ?pre-election rally?. The market had reasons to be optimistic, as opinion polls indicated that Congress had good prospects of returning to power and anybody could have provided better governance than the incumbent government. Of course, what followed after the swearing in of Narasimha Rao?s government and Manmohan Singh?s first budget is folklore.

May 1996
Though Narasimha Rao?s government managed to complete five years, the last two years were bad. The economic policies of the government were viewed as elitist and pro-rich. There was dissent within the Congress Party. As a result, the government tried to unleash reforms with a ?human face? (euphemism for inflation taming). The tightening of credit led to the industrial downtrend while the masses still felt alienated from the reform process. A number of regional parties emerged, capitalising on the electorate?s disenchantment.

May 7th 1996: The election process went through smoothly and, for the first time, an election commissioner became a hero! However, the outcome was a fragmented mandate. BJP with 162 seats emerged as the largest party, while Congress got routed. A number of regional parties emerged. Janata Dal and the Left parties decided to form the ?National Front?, a third alternative. The BJP formed the government under Vajpayee but lost the vote of confidence. The Government lasted for a mere 13 days and the National Front assumed power with the passive backing of Congress. The politician-statesman combination continued with Deve Gowda and Chidambaram.

The market?s ?pre-election rally? was more pronounced this time around, as it rallied from 3485 to 3796. The elections were viewed as a big relief by the market. Renewed expectations were built up of a new government easing credit and increasing expenditure to boost the economy. However, the fragmented mandate dampened the spirits of the market but it never let it show, remaining steady at 3800 levels. When Chidambaram became the finance minister, the market turned ecstatic as he had played an equally important role in implementing reforms as the commerce minister in Narasimha Rao?s government. The market opened the cork and got past 4000! Bonanza time?a pre-election rally & a post-election rally. Wah! Wah!

February 1998
Post-1996, politicians started grappling with the realities of coalition government. The multi-party government that had been formed consisted of a number of regional parties who felt that their aspirations were being sacrificed at the national altar. The Congress played truant too. In the end, the country was forced to go to polls again.

The electorate was frustrated with the performance of its elected representatives. BJP emerged stronger from all the political squabbles. BJP outdid its performance in the previous elections and got 181 seats, while the Congress did better too. However, the Janata Dal and its allies badly lost. The country voted for a national party. The elections were also a pointer to the fact that the political parties had to learn to balance between their own regional aspirations and national priorities. Electoral forces were ensuring that the political community split as BJP & non-BJP. After 50 years of Independence, the Congress had finally been sidelined...

The market was completely disgusted with the happenings on the political front. The market had a subdued performance, trading around 3450 levels (back to 1996 levels). The market was tired of hoping. However, the poll results had the market completely excited as BJP came to power raising hopes of a stable government and hence, stable progressive economic policies. The market partied, crossing 4000 within a month of the Government being sworn in. Little did the market know of Pokhran and the ?Jaya? bomb awaiting it! The post-elections rally more than made up for the pre-election rally that did not happen.

September 1999?
The selfish interests of most politicians are still in conflict. Hence, there are too many parties fighting the polls. The Congress has split too with frontline leader Sharad Pawar going on his own. The National Democratic Alliance formed by BJP and its allies seem to be in a stronger position. However, a vote swing against the ruling government might upset the results.

Congress is running an aggressive campaign, hitting hard at BJP rather than issues, in order to capitalise on this anti-incumbency factor. Are we headed for a hung parliament again?!

The market has been busy chanting the economic recovery and corporate recovery themes, turning a blind eye to the elections. However, the looming elections are giving many investors the jitters. If this week?s market declines were to continue, then for the first time we might have a pre-election sell off! However, the saving grace is that both BJP and the Congress speak the same language when it comes to reforms. In fact, BJP seems to have taken a more aggressive stance on the reform process. The adverse market conditions forced the Indian corporates to restructure and shape up in order to survive, leave alone do well.

Will the Indian electorate teach the political parties a lesson by punishing contestants who have not worked either for their constituencies or in the interests of the nation? That is without doubt - the electorate has cast its vote well in the past, throwing out one incumbent government after another, only to find the next government equally ineffectual if not incompetent. That is about as strong a message as the one that the stock market has made over the past 4-5 years - rewarding companies with good practices and trashing the bad ones. The issue is: when will the elected leaders do their duty to the nation by governing responsibly? The answer to this unfortunately lies in the realm of the unknown.

As of now, the economy has displayed some stirrings of life and the environment is conducive enough for it to perhaps trundle along at a faster pace, going forward. We are clearly on a cyclical uptrend at this point of time. But can we enjoy the kind of bull run that we have seen in the US over the past 7-8 years? Without an enlightened government, that will remain a fantasy. The current revival in the markets will reflect just another cyclical upturn in the economy that can last for two years; and the market will retreat as and when the economic cycle reverses. Hopefully, somebody will knock wisdom into the heads of our politicians before it gets too late.

Article 6: A costly game

(Numerous people are trading in shares of companies and to take part in this hugely popular game...)

There is a very costly game that a large number of people are indulging in these days. The game involves trading in shares of companies. This popular sport has logged in an aggregate turnover (Bombay Stock Exchange + National Stock Exchange) of Rs10,70,000cr during the period April-September.

The ten most popular stocks that game participants are trading in include worthies such as Himachal Futuristic, Satyam Computer and Zee Telefilms. Together these three hog as much as 75% of the stock market's version of television rating points (TRPs).

HFCL steals the thunder
However, the stock that steals the thunder with 15 TRPs is the 'born again' telecom-cum-

software-cum-entertainment company, HFCL. This all-rolled-in-one ICE heavyweight has recorded a trading volume of Rs148,209cr during the April-September period this year.

Game participants love it

At today's closing price the market capitalisation of the company is Rs12,000cr. This makes HFCL among the 10 most valuable companies in the country. Maybe a place in the Sensex beckons! Game participants (investors, traders and what have you!) eager to own a share of this ICE heavyweight have turned the company over a dozen times in the past six months (that is Rs148,209cr worth of HFCL shares have changed hands during the period as against a market capitalisation of Rs12,000cr)

But they don't want a long term relationship

HFCL is expected to report a profit in the region of over Rs250cr this year, a growth of over 150% year on year. In the ICE age it is only understandable that every market participant worth his salt wants to own a two-bit share of this company. However, data indicate nobody really wants to own this company for too long. HFCL has been bought and sold lock, stock and barrel a dozen times over. Wonder why nobody wants to hold on to this ICE maiden for very long!

So, how much does a player pay to take part in this hugely popular game where the prize appears to be not a long lasting relationship with great stocks but a **one-night stand**?

Well, any game involves some costs

In this case, it is the brokerage that the game participants incur while buying and selling shares of a company. Let's assume that the participants in this game pay a brokerage of 0.1% every time they trade (and that is a pretty realistic estimate of brokerage rates prevailing in the country!). That throws up a figure of Rs148cr!

It takes two to tango

Now remember that in this game there has to be a seller and a buyer. It takes two to tango after all. Hence, the total fees paid by buyers and sellers in this game amounts to Rs296cr. And this is the cost of the game for six months. If this blockbuster continues to play all over gaming rooms in the country for another six months the game participants would have shelled out a rich sum of Rs600cr!

All of this in an effort to take control of a company that will generate a net profit of just Rs250cr this year! Do they know something we don't or have they forgotten to do the arithmetic?

Article 7: The dear, dear stock market

(Ever paid a 20% tip? Read on to discover how much you 'spend' on your brokers...)

Remember that costly game?
The one in which you (and zillions of other market participants) offer to pay your broker, by way of transaction costs (brokerage), twice the amount of profit that a company (HFCL) will report.

Well, one of our readers took offence to that story and wanted to highlight that it was not only HFCL that was prone to this kind of misplaced arithmetic by 'investors'.

Gentle reader, we agree with you. We used HFCL as the flag bearer for our story only because it topped the charts in terms of trading volumes. This flawed arithmetic is not a malaise that affects HFCL alone. It affects the market as a whole. Step back in time and take a look at the words with which we started our story.

"There is a very costly game that a large number of people are indulging in these days. The game involves trading in shares of companies. This popular sport has logged in an aggregate turnover (Bombay Stock Exchange + National Stock Exchange) of Rs10,70,000cr during the period April-September 2000."

It is not about the Rs600cr that investors will shell out of their pockets while trying to shuffle the cards (HFCL shares) even while the company itself will report profits of only Rs250cr. It is about the Rs2,140cr that investors have shelled out of their pockets during the 6-month period ended September 2000. Mind you, this is a conservative estimate, calculated on the basis of a 0.01% brokerage charge on turnover; that amounts to Rs1,070cr and since brokerage will be payable both by the seller and the buyer, the total bill tots up to Rs2,140cr. Extrapolating this number, investors would shell out a sum total of Rs4,400cr during this financial year.

Investors dole out about 16-18% of their companies' profits in trading
The combined market cap of all stocks listed at the BSE is estimated at Rs6,20,000cr (Oct 23, 200). Let's use that number as the benchmark for capitalisation for all stocks in the country, as the number of companies not listed at the BSE is quite low.

The Sensex, which accounts for nearly 45% of the total market capitalisation, trades at a P/E of 18.5x FY2000 earnings. Let us treat this number as being an accurate representation of the P/E for the whole market. That means that the companies that make up the total market would have a combined profit of between Rs33,000cr.

So investors as a body are doling out almost 13.5% of the profits that their companies will earn this year. And this number will climb higher when you account for the fact that we have not included transaction costs incurred by people trading at the Calcutta Stock Exchange, Delhi Stock Exchange and even the Nasdaq, NYSE, Luxembourg and London stock exchanges (where Indian GDRs and ADRs trade). Take all of that into account and transaction costs would rise as high as maybe 16-18% of all the profits generated by these companies.

So there you have it - investors as a whole are doling out as much as 16-18% of all profits generated by their companies as they go about tossing shares at stock

exchanges all over the world.

Do you think that is a good idea or even wise?
You tell us. Mind you, this is not just an Indian phenomenon. This is a global phenomenon. Listen to what renowned investor Warren Buffet has to say on this subject in an extract from a Fortune article published in 1999.

"Bear in mind - this is a critical fact often ignored - that investors as a whole cannot get anything out of their businesses except what the businesses earn. Sure, you and I can sell each other stocks at higher and higher prices. Let's say the FORTUNE-500 was just one business and that the people in this room each owned a piece of it. In that case, we could sit here and sell each other pieces at ever-ascending prices. You personally might outsmart the next fellow by buying low and selling high. But no money would leave the game when that happened: You'd simply take out what he put in. Meanwhile, the experience of the group wouldn't have been affected a whit, because its fate would still be tied to profits. The absolute most that the owners of a business, in aggregate, can get out of it in the end - between now and Judgment Day - is what that business earns over time.

"And there's still another major qualification to be considered. If you and I were trading pieces of our business in this room, we could escape transactional costs because there would be no brokers around to take a bite out of every trade we made. But in the real world, investors have a habit of wanting to change chairs, or of at least getting advice as to whether they should, and that costs money - big money. The expenses they bear - I call them frictional costs - are for a wide range of items. There's the market maker's spread, and commissions, and sales loads, and 12b-1 fees, and management fees, and custodial fees, and wrap fees, and even subscriptions to financial publications. And don't brush these expenses off as irrelevancies. If you were evaluating a piece of investment real estate, would you not deduct management costs in figuring your return? Yes, of course - and in exactly the same way, stock market investors who are figuring their returns must face up to the frictional costs they bear.

"And what do they come to? My estimate is that investors in American stocks pay out well over $100 billion a year - say, $130 billion - to move around on those chairs or to buy advice as to whether they should! Perhaps $100 billion of that relates to the FORTUNE-500. In other words, investors are dissipating almost a third of everything that the FORTUNE-500 is earning for them - that $334 billion in 1998 - by handing it over to various types of chair-changing and chair-advisory `helpers'. And when that handoff is completed, the investors who own the 500 are reaping less than a $250 billion return on their $10 trillion investment. In my view, that's slim pickings.

"Perhaps by now you're mentally quarreling with my estimate that $100 billion flows to those `helpers'. How do they charge thee? Let me count the ways. Start with transaction costs, including commissions, the market maker's take, and the spread on underwritten offerings: With double counting stripped out, there will this year be at least 350 billion shares of stock traded in the U.S., and I would estimate that the transaction cost per share for each side - that is, for both the buyer and the seller - will average 6 cents. That adds up to $42 billion.

"Move on to the additional costs: hefty charges for little guys who have wrap accounts; management fees for big guys; and, looming very large, a raft of expenses for the holders of domestic equity mutual funds. These funds now have assets of about $3.5 trillion, and you have to conclude that the annual cost of these to their investors - counting management fees, sales loads, 12b-1 fees, general operating costs - runs to at least 1%, or $35 billion.

"And none of the damage I've so far described counts the commissions and spreads on options and futures, or the costs borne by holders of variable annuities, or the myriad other charges that the `helpers' manage to think up. In short, $100 billion of frictional costs for the owners of the FORTUNE-500 - which is 1% of the 500's market value - looks to me not only highly defensible as an estimate, but quite possibly on the low side.

"It also looks like a horrendous cost. I heard once about a cartoon in which a news commentator says, `There was no trading on the New York Stock Exchange today. Everyone was happy with what they owned.' Well, if that were really the case, investors would every year keep around $130 billion in their pockets."

Words to chew on, no doubt!

By the way, in our estimate, we did not include the fees charged by mutual funds to their investors, which is another transaction cost! If you take that into account, the number is likely to climb even further - in excess of 20% all profits!

A costly game indeed!

Article 8: Voting for stocks

(Does the stock market really separate the wheat from the chaff?)

All voting is a sort of gaming, like checkers or backgammon, with a slight moral tinge to it, a playing with right and wrong.

- Henry David Thoreau

Voters Take Their Turn After Marathon Campaign

- 7/11/2000 Reuters report on US 2000 elections

We have all cast votes in some election or the other. It could be an election to elect our class representative in school or an election to elect the MP of our constituency. Many of our votes made candidates win. Nevertheless, have you ever wished sometimes that if only you had another chance, maybe you would have voted for another candidate who would have done better. Or do you sometimes feel let down by the person you cast your vote for?

Now, imagine a situation where you could cast your vote during the entire tenure of a government on an ongoing basis, say every month? a general election every month! If this were to be true, how would things change?

Since all of us have certain expectations from the candidates we cast our vote for, the ongoing elections will give us an opportunity to vote 'out' a candidate who does not meet expectations or shall we say fulfil the *mandate*[1] and vote 'in' candidates who have a better chance of doing well. In other words, over a period, we will be able to weigh the candidates collectively, thereby recognising their true abilities to deliver on *their promises* to meet *our expectations*.

As a result of this ongoing collective action, the candidate/ party that comes to power cannot take the mandate for granted. After all, if they do not fulfil the aspirations of the electorate that voted them in, they will soon be voted out of power! Hence, the steady state situation is that, at any given time, representatives who are best suited to meet the expectations of the people at large will be in power.

Another supreme democratic institution - the stock market!
The electorate here is the shareholder. The management of the company has the mandate to maximise the electorate's wealth. 'Wealth' - that is the operative word in this institution. Unlike the government where its actions help a country progress, and ensure the well being of all its citizens. The shareholder here parts with his 'capital' when he casts his vote to support a business that he expects will in the end grow his capital!

Since there is wealth involved and the electorate's capital is at stake, his vote comes in the form of a 'price' he is willing to buy. A price that ensures maximisation of his returns on his capital! Unlike a once-in-four-or-five-years general election, the stock market provides the shareholders an opportunity to cast their vote every second, every trading day. An opportunity to price the businesses in terms of their ability to maximise wealth for them.

Often bad businesses just get voted out of the market too! The collective action of these shareholders ensures that the businesses reflect their relative abilities to create wealth for their shareholders.

Of course, one can infer at this stage that as the participants in the stock market increase to cover the larger part of the population, there will be convergence (since the word has become so popular) of what is good for the consumer and what is good for the shareholder. Anyway, that is a different story!

The stock market: voting machine or weighing machine?
"In the short run, the market is a voting machine - reflecting a voter-registration test that requires only money, not intelligence or emotional stability - but in the long run, the market is a weighing machine."

- Benjamin Graham

But does the market really end up being a 'weighing machine' in the long run? Between November 1999 and February 2000, any software stock you touched turned into gold. Let's take the instances of Infosys, the established leader, and Silverline Technologies, the desperate wannabe-Infosys. In November 1999, Silverline appreciated by 63% while Infosys appreciated by just 39%. The markets in their frenzy were bidding up Silverline expecting it to outshine Infosys. But did it mean that it actually did?

Nope. The market realised its folly very soon, which is why between 1st December 1999 and 30th November 2000, Infosys appreciated by 57% and Silverline declined by 46%.

Why did this happen?

A temporary madness
Take a look at the big picture for these two stocks?

In order to even out the fluctuations caused by the daily voting pattern of the market, we have taken the simple average of prices over the 30-day and 100-day period. Notice some correlation between the average prices and the profit growth of these two companies?

The growth in profits has dictated price movements or shall we say the market has recognised the stocks for their individual merits.

Despite the fact that Silverline is in a high growth sector and has the advantage of being small sized, the company has compounded profits at 63% p.a. whereas Infosys has compounded profits at twice the rate (126% p.a.). By now, you know enough of compounding to work out what this differential can do over even a short period of three years.

Hallelujah! Praise the stock market. It has it all figured out in the long run. It does get carried away sometimes but never fails to recognise its mistake and get back on course.

In a very simplistic manner, we found for ourselves how the moving average prices over a period track the change in the underlying profits. Every participant casts a vote in the stock market every time they trade. There are a few people who keep polling everyday while there are the others who step in whenever they spot a distortion in the long-term trend of the business that provides an opportunity to make some big profits. Of course, many of you know these two categories of participants as 'traders' and 'investors'.

Next time, we will understand these people a lot better. We will also understand why it is important to have more number of people and more number of shares to be traded in order to make the stock market an effective institution.

1.**Mandate:** an authorisation to act given to a representative

Article 9: Blame it on the big bad wolf?

(Small investors have themselves to blame more than the speculators)

Speculators prey on the small investor, or do they?
Speculation. The word has a dirty twang to it. The speculator is bad. The small investor is good. Or so we are told everyday. The speculator is the Big Bad Wolf who preys on the Little Red Riding Hoods (read small investors) in the stock market jungle.

This is popular perception.

What surprises me after all these years of hearing this litany of complaints against the speculator is the ease with which the little ladies continue to enter and stay in the financial jungle. Actually, referring to the Little Red Riding Hoods as "small investors" might itself be misplaced. The term 'small speculators' might describe them better.

Look at the reality - less than 10% of the traded volumes are settled by way of delivery and institutions account a significant proportion of such trades. In other words, even small investors are up to their neck in speculation.

Unfortunately, Little Red Riding Hood does not seem to realise that it is not the Big Bad Wolf that is responsible for her problems. She is playing the game all wrong. And it takes some

basic arithmetic to figure out the error of her ways.

There must be some traces or scent that the little lady leaves behind in the financial jungle. After all, she is in the market already. Let's do the arithmetic behind the tr(e)ading pattern of the lady.

For that we need some numbers, some averages. But we need not look far. The average trade value should be a good indicator of the appetite of the little lady (not the wolf). Based on last Thursday's data (and you can do this math based on the day's trade data published in any of the business papers) the average trade value of some leading stocks is as follows: Satyam - Rs1.13 lac, Zee - Rs0.75 lac, Infosys - Rs.1.28 lac and HFCL - Rs1.6 lac.

Given that institutions trade in bigger ticket sizes, it is likely that the average value of the trades done by our little lady is even lower than average. So how much money does the little lady bring to the table? If we presume an average margin of 30%, then the capital that she brings to the table could be anywhere between Rs30, 000 and Rs50,000.

Okay, that sounds small! But what happens when our little lady trades on this size (ie Rs50,000) of capital every day. Again apply an average brokerage charge of 0.1% and presume that the little lady trades her entire capital every trading day. She would incur a cost of Rs38,400 over the period of a year (240 trading days). In other words, she would start to break even only when she begins to earn 78% on her capital.

She starts making money after that. My advice to the Little Red Riding Hoods of the world: it's not that the world is biased against you and is in favour of the Big Bad Wolf. You are playing the game all wrong in the first place.

Article 10: Red Riding Hood: Be patient

(If you must speculate then so be it, but you must have a plan. Otherwise...)

Research done on the usage of finance websites by the denizens of the Internet suggests that most visit the sites for just one reason, stock prices!

Writing on Sharekhan we do often wonder whether the message that we are trying to send out is actually being heard. Or does it just lie there as some moralistic advice delivered from a high pedestal with no practical value? The last thing we would like the Sharekhan School to be is a textbook. A textbook that is considered to be full of theory and divorced from reality. That is of no practical value to the investor or to the speculator for that matter. The Sharekhan School is the collection of our experiences and learning. And we have not stopped learning, neither should you.

So much for that emotional outburst! What, you may wonder, has led to such an outpouring on my part.

Well, it has to do with the response that an earlier piece Blame It on the Big Bad Wolf? generated. In it I had argued that the reality of the market is that the small investor is actually a small speculator. Neither is she Little Red Riding Hood nor is the Big Bad Wolf (read Operators, Speculator) to blame for her woes. Little Red Riding Hood loses because she plays the game wrong in the first place.

This led a Sheru, **mhsmony**, to state as follows:

I quite agree with your statement that we play wrong game first time. But considering the stop loss, say, @3% how can one risk more than that? Should you conclude that this is not our cup of tea for small player and avoid the same? Could you suggest the no of trades and volume which

will go a long way in helping the small investor? The article will be complete only then. Please advise mhsmony@yahoo.com Thanks and regards

Yes, the reality is that there are a large number of speculators out there. I am not against speculation. Nor am I against trading. But there must be method in this madness. Particularly so because trading is a risky business to begin with -- one that is more often than not played with borrowed money (that is what trading on margin amounts to). It is a game in which the impact of transaction costs is often underestimated and worse still, ignored.

The truth is that it does not matter whether you are a small speculator or a large speculator -- the arithmetic as I presented it in the earlier piece is the same for both (I'm surprised none of you pointed that out)! The bottom line of my point is that if you want to make money by trading, then you must realise that the key to your profitability is your "transaction cost" or in other words, the brokerage and other costs that you incur when you transact.

The transaction cost eats into your trading profits and of course if you make only losses, then the transaction cost only adds to your losses. Unfortunately, it is this cost which more often than not is the cause for ruin for most speculators. That and the reluctance to follow the golden rule of trading: "Cut your losses, let your profits run".

Success in trading rests on two issues: (1) your ability to follow this golden rule and (2) the transaction cost that you incur. And transaction costs are a function of the cost that you incur per trade multiplied by the number of trades that you do.

Let us assume that you are able to follow the golden rule to the T and are also able to get the best possible deal on brokerage (per trade transaction cost). The only other variable that comes into play then is the number of trades you execute. The Big Bad Wolf in other words, ladies and gentleman, is trading more frequently than is justified.

By trading everyday, as Little Red Riding Hood did in our fable, you are acting against your interests. You are allowing yourself to fall victim to the Big Bad Wolf because **you have set yourself an impossible target -- that you will break even only after you have made 78% -- in the first place**. Talk about losing the battle even before it has begun!

My dear "mhsmony", unfortunately, I cannot offer a solution to your problem. It is not for me to tell you how many trades should be right. If you are a good enough trader to earn 150% a year, then by all means trade everyday. But if you believe you can hope to make only 50% before transaction costs, then you must inevitably conclude that you cannot trade everyday. In other words, you need to determine how often you will trade based on how much you believe you can earn.

To trade more would be foolish. I have worked out a range of per trade costs and number of transactions in the table below, which will enable you to set the benchmarks. But the choice of what is right for you is a personal decision that you must make. I can only show you how the odds stack up against you.

Amount of capital	Rs 1,00,000
Margin	33.33%
Value of trade permitted	Rs 3,00,000

Transaction costs -

No of trades per year	Brokerage rate		
	0.10%	0.15%	0.20%
50	Rs 15,000	Rs 22,500	Rs 30,000
100	Rs 30,000	Rs 45,000	Rs 60,000
200	Rs 60,000	Rs 90,000	Rs 1,20,000
300	Rs 90,000	Rs 1,35,000	Rs 1,80,000
Value per trade - Rs 3,00,000			

Spend a minute on the table. Infact spend more than a minute. **Do you, in all honesty,. believe that you can make money even after incurring some of the huge transaction costs shown in the table?**

I hope this will help you reach an informed decision. I also hope this will sound a warning to the die-hard traders amongst you to whom visiting your broker's office or trading over the Internet is almost a habit -- much like that morning cuppa.

One last thought before I sign off ?

While I have no statistical evidence, anecdotal evidence suggests that traders, who do not trade indiscriminately and instead wait patiently till the opportunity presents itself, tend to do better than those who trade compulsively everyday. Being patient and trading only when justified appears to improve your chances of making money in the first place.

Article 11: What ticks the stock prices?

(Who or what send stock prices on their rollercoaster rides? The story so far...)

The short story vs. the epic

In the short run, stock prices are dictated more by market sentiment or demand-supply mismatches. But in the long run, stock prices value the earnings of the underlying business.

"In the short run, the market is a voting machine - reflecting a voter-registration test that requires only money, not intelligence or emotional stability - but in the long run, the market is a weighing machine."

- **Benjamin Graham**

If Thomas Alva Edison were a stock market analyst, he would have remarked that short run stock prices are determined by 99% sentiment and 1% fundamentals. On the other hand, stock prices in the long run are determined by 1% sentiment and 99% fundamentals.

The two forces in play

Since there are two broad tides that influence stock prices, it is logical that the participants in the market are broadly split into two categories:

1. Those who try to profit by swimming with the 'sentiment' tide that influences prices in the short run. They are popularly known as 'traders'.
2. Those who try to benefit from the 'fundamentals' tide that influence prices over the long run. They are popularly known as 'investors'.

By now we know that prices in the long run track earnings per share. Of course, this is a fairly obvious conclusion - what else would one pay for? Every shareholder owns a part stake in the business and is thereby entitled to a proportionate share in the profits of the business.

Traders and investors: spot the differences!
Now imagine this: Given that stock prices track earnings over longer periods, if every participant turned a buyer for the long haul, how would the market subsist? Huh, so what happens to the traders? In such a scenario, what would distinguish a trader from an investor?

A-ha, but that's not all - the plot thickens! What adds the interesting twist to investing in stocks is that earnings from a business are uncertain. They depend on many factors, some of which affect all businesses like an epidemic while the rest affect individual enterprises at a business level . In this manner, the interplay of these influential factors creates diversity of opinion, one of the basic requirements for a fair market place.

Traders and investors alike cast their vote every time they buy or sell a particular stock. The stock price at every moment in time reflects the resultant of the collective action of the market participants at that moment in time.

Differing reasons and bases for making a call
Traders poll in everyday based on their judgement of how information on the 'factors of influence' will affect stock earnings and hence prices. After all stock prices are based on expectations of uncertain future earnings. As information flows in, the traders poll in to profit from short time gaps between reality and expectations. The only factors that keep changing often are the factors that influence all stock prices.

Traders can only hope to maximise profits by trading as many times in the short run that will keep fetching them small time profits. Hence, these traders thrive on volatility.

Buying based on mismatches in price and value
'Traders' as a class expect to be rewarded by the 'investors' for pricing the short-term factors of influence right! After all a trader has a position in a stock, hoping to profit from the short term mismatches. In the process, the trader hopes to get rewarded by the investor who helps offset the trader's position.

On the other hand, investors buy stocks hoping to benefit from the growth in earnings. Hence they respond to factors that influence the trajectory of growth. Hence, the most basic style of investing will always be "Growth Investing"!

However, there is another evolved investing style adapted by investors. There are occasions when there are large gaps between the value of a stock and the potential earnings that can

accrue to the shareholder in the future. These gaps normally result from misunderstanding the business specific factors of influence and correct over a longer period of time. Investors poll based on these mismatches too. This style of investing is popularly known as "Value Investing".

Of course, it is a difficult to clearly state who is a 'trader' and who is an 'investor'? A better way to distinguish them is from what tide they hope to profit from! The worst state is to be thinking like one and acting like the other.

Time is another distinguishing factor

A critical element that creates diversity of opinion and hence a fairer market is time. One, factors that affect businesses change over a period of time. Two, since traders and investors have different time horizons, their views on the impact of these factors of influence varies in degrees.

Lost? Consider a sharp fall in Nasdaq in a single day. The impact of a sharp decline has a lot of effect on the short-term perception of Indian technology stocks. However, in the long run, the earnings of Infosys, say, is not impacted by a day's decline in the Nasdaq.

Hence a trader is likely to react negatively to the single day decline in NASDAQ where as an investor would be unfazed. In fact, the 'value' investors will step in if the prices reach attractive levels, thanks to the terrified traders.

However, a sustained decline in Nasdaq may have the potential to set panic attacks among the usually serene investors!

Time is also the great leveller

"Time destroys the speculation of men, but it confirms nature."

- **Marcus Tullius Cicero (106BC - 3BC)**

Time is the great leveller.

Traders get to know soon whether they are right or wrong, but investors have to wait for a long time. Hence, 'humility' is a trader's virtue while 'patience' would be associated with an investor.

We have covered a lot of ground in understanding the markets and its participants better. Though it seems that the existence of traders is essentially derived from the existence of investors, it is a symbiotic relationship - I scratch your back, you scratch mine!

More on this later.

Article 12: Poles apart

(Understanding why trading and investing can never go together)

The story so far?

"Voting for Stocks" helped us in understanding that there is a method to the madness. Stock price movements though they seem fickle in the short run, track only the earnings per share in the long run.

"What ticks stock prices?" established a clear demarcation between actions of traders and investors.

Now it is time to move on?

Why are trading and investing so very different? Is there a one fits all strategy for trading and investing? Or something even more basic?

Are stock prices in the short run really 99% sentiment and 1% fundamentals?

Remember the post-Pokhran market in May~June 1998? Take a look at what the prices of some of the leading stocks did after the market sentiment took a beating between May 20, 1998 and June 19, 1998.

	20-5-98	19-6-98	% Change
Sensex	3957	3143	-20.57%
HLL	164	151	-7.93%
ITC	822	612	-25.55%
Infosys	637	525	-17.58%
Ranbaxy	323	257	-20.43%
Satyam	56	32	-42.86%
Pentasoft	523	253	-51.63%
Zee	51	38	-25.49

Most stocks took a severe beating. The index declined by 21% and every stock from Infosys to Satyam declined between 20%~ 45%. All stocks came undone irrespective of which sector they belonged too. The market turned blind to the fact that the underlying businesses of these stocks had different potentials. A classic case of the market fury burning every stock in sight or should we say sentiment dictating 100% of the price movement.

However, stretch the horizon from May 20, 1998 to March 5, 2001.

	20-5-98	19-6-98	31-12-98	31-12-99	31-12-00	05-03-01
Sensex	3957	3143	3055	5005	3933	4003
HLL	164	151	166	225	207	226
ITC	822	612	750	665	895	741
Infosys	637	525	753	7693	5536	4840

Ranbaxy	323	257	268	923	671	706
Satyam	56	32	76	440	308	247
Pentasoft	523	253	367	1336	292	138
Zee	51	38	72	1093	227	114

The picture tells us a different story. No points for guessing that the disparate prices of various stocks reflect the respective business potentials that got revealed a lot more in the intervening period.

Interestingly, these stocks could have shown similar price movements for a brief period post-break out of the Kargil conflict or the debacle of the market in April 2000. One could also examine the recent washout in tech stocks and discover that a leader like Infosys and a third rung software stock met with similar fate.

Just in case, you are wondering that sentiment wrecks havoc only on the way down. It has a similar impact during bullish periods!

Clearly, the rules that govern prices during the short term and the long term are different. Imagine taking a trading position in Infosys for a week on May 20, 1998 after being impressed with the financials of the company. You still would have lost big money on your leveraged trading position.

Similarly, imagine being bullish on the technology sector in May 1998 and buying a stock like Pentamedia. The stock is down from Rs. 523 to Rs. 138 where as an Infosys despite the recent carnage in tech stocks is up 660% since then! If pentamedia was the darling of the speculators then, here is another example of a low profile tech stock -Tata Infotech (the stock quoted at 1133 on May 20, 1998 and trades at 163 in March 2001).

A clear case that it is the merits of the individual stock that matters in the long run even during favourable times.

Methods and means cannot be separated from the ultimate aim.

- Emma Goldman (1869 - 1940) US anarchist

All of us know that investing requires understanding businesses, projecting financials and evaluating the price of the stock vis-?is its potential, what is commonly referred to as 'fundamental analysis'.

Trading is the trickiest of all. Since it involves dealing with fickle sentiments, demand supply mismatches over short time spans. Studying price/volume charts and trading with stop losses is critical. Disciplined application of the trading rules determines the ability to profit.

Hence, the approach to trading and investing has to be very different. They can never be the same.

As Rudyard Kipling said,

> OH, East is East and West is West, and never the twain shall meet,
> Till Earth and Sky stand presently at God's great Judgement Seat;
> But there is neither East nor West, Border, nor Breed, nor Birth,
> When two strong men stand face to face, tho' they come from the ends of the earth!

He might as well have been talking of trading and investing in the stock market.

An interesting question at this stage is should somebody new to the stock market start off by trading or investing in the market. Next time we shall answer this dilemma.

Article 13: Discount sale!

(Why are there no takers for stocks when stock markets crash? Why do market participants buy whe...)

Upto 60% off on Arrow Shirts. Offer till stocks last!

If you were to spot this in your city, it is very likely that you would have rushed to the shop to grab a few shirts. In fact, there are many of us who keep an eye for these kinds of sales to fill up our wardrobe.

We don't even blink at the fact that lower prices increases off-take of goods. After all, classical demand supply equation in the real world dictates that demand increases at lower prices. Hence, prices at a discount to their perceived value should make merchandise move. In our case, it is the Arrow shirts.

But do these market forces that we take for granted work everywhere?

Stocks on sale
Why are there no takers for stocks when stock markets crash? Why do market participants buy when the prices start appreciating?

This strange behaviour of the stock market becomes painfully evident when the prices crash and there are no buyers L

The obvious reason is that you buy a shirt for the value that it offers today not because you hope to sell it back at a profit to somebody else tomorrow. On the other hand, you buy a stock for its future appreciation in value. So when stock prices come off, there is always an expectation that they will be available cheaper tomorrow.

Hence the successful purchase of a stock is one that appreciates today, tomorrow and the day after too!

This uncertainty about future prices is what makes stock price behaviour very different from the real world. As a result, declining stock prices do not necessarily mean that buyers will flock in.

Thus, in the stock market there are periods when there is a collective consensus that stock prices can only appreciate. These periods typically occur at the extreme of a 'bull market' (Remember Feb 2000?). At this extreme everybody wants to buy because it might be too late to buy tomorrow and nobody wants to sell.

Similarly, there are periods of collective consensus that stock prices can only decline. Such periods typically occur at the end of a 'bear market' (Dec 1998?). At this point nobody wants to buy, they want to wait for prices to fall further before buying. And those who already own stocks want to get out so that they can get back in later and cheaper!

For many of you this behaviour of the market is nothing new. However, this is an interesting corollary. If there is a collective consensus in the market on the future direction of prices either up or down, then that event is more unlikely to happen.

Here is why?
If 90% of the market participants think that all the stocks will be available cheaper the next day, then most of them would have sold the stocks they hold. They must be mad holding it when they are so sure! The smarter ones would have short sold. The next day there are only willing sellers and no buyers. All it needs then is one buyer or somebody to change their mind J

Next time when everybody around you is sure that stock prices will fall further tomorrow and the day after, be ready to turn a buyer.

But then how would you protect yourself from the uncertainty that could still persist?

You can rein in the uncertainty by buying more than one stock. Basically, put your eggs in more than one basket.

In fact, a big benefit of having a diversified portfolio is that the fortunes of your investment do not depend on just one stock. Hence, you would be more inclined to buy a beaten down stock, which could ultimately prove rewarding over time.

Stretch your investment horizon
A better way to reduce risk is to stretch your investment horizon. Imagine buying a good stock when everybody has turned negative on the market with a five-year horizon. There are scores of examples available. In fact 'Voting for stocks' highlights how the seemingly insurmountable short-term uncertainty disappears over the long term.

The key is to always retain once perspective during extreme periods for the market.
When everybody looks at stock prices trading at a steep discount and believes that they will get it even cheaper tomorrow is probably when you need to grab the offer.

Article 14: Regarding stock prices

(Boom or bust, up or down. Do fundamentals really determine stock prices? Find out...)

What ticks the stock prices? A question worth all our capital. Earlier in school we sat on the shoulders of Benjamin Graham to understand that 99% sentiments and 1% fundamentals drive stock prices in the short run whereas 1% sentiments and 99% fundamentals dictate stock prices in the long run.

Here is how the Merriam Webster dictionary defines "sentiment" and "fundamental".

Sentiment: *an idea coloured by emotion*
Fundamental: *belonging to one's innate or ingrained characteristics*

Most of us find it difficult to believe that fundamentals really work in the market! However we stumbled on an event that can demonstrates that fundamentals really matter in the long run. It is an event of long standing nature that we presume most of us can relate to. It has to do with corporates being allowed to buy back their own shares.

The event unfolded
The Sensex trades at 3300 as dealers in hushed tones talk of a new law in the coming budget--

buy back of shares. Gradually these hushed exchanges reach a crescendo and the market starts chanting, "buy back, buy back, buy back!" It appears all too easy. Buy shares from the market and sell it to the company. J

Traders have already identified their favourite buy back candidates: GE Shipping, Bajaj Auto and Reliance. All the three stocks rally with the market (check the respective price charts). But alas, the budget falls shy of introducing the bill that would have allowed these companies to buy back their shares.

Then there's a change in regime at the centre. The "buy back" chants rent the air again. The new government is expected to announce a law allowing buy-back in the interim budget of June 1998. Speculation is rife again. But once again, the budget gets passed without any amendment to the company law to allow companies to buy back their shares.

The Pokharan blasts take precedence over the budget. The market slips below 3000 and so do the prices of the three stocks.

Finally on November 14, 1998, the law is passed that allows companies to buy back their shares. The market also registers a bottom around the same time. The Sensex rallies between November 1998 to February 2000, but apart from Reliance, none of the other two buy-back favourites--GE Shipping and Bajaj Auto--show any appreciation in price. In fact Bajaj Auto declines by 40% during the period when the Sensex posts a 100% gain!

In the end all these favourite buy-back candidates announce their buybacks.

The market was right
GE Shipping announced that it would buy back shares with an upper cap of Rs42 in October 2000. The stock price was Rs26 when the announcement was made. The company completed the buy-back in April 2001. But guess what? The stock never hit Rs42!

Bajaj Auto's board approved the buy back on July 30, 2000 at Rs400. The stock price not only failed to touch Rs400 but it also declined once the offer period lapsed. Of course, it was not an open market buy-back.

Reliance Industries proclaimed in June 2000 that it would buy back shares at Rs303. When it made public its buy-back intentions, the stock was trading at Rs340. Barely four months later the stock was at Rs287. Almost a year after it announced its intentions, the company has yet to buy back its shares. But the stock price trades close to Rs400 levels.

In the end buy-back of shares turned out to be a big hype.

So if it wasn't the buy-back event itself, what really worked for these three buy-back favourites?

If you turn the clock back again, to the period between March 1997 and May 2001, you will notice the jigsaw pieces fall in place. The price patterns of each of these stocks tracked the direction of their respective earnings growth during the period.

What is the moral of the story?
It is a reinforcement of what we already know but find hard to believe. That the market

collectively gets carried away in the short run by ideas coloured by greed or fear, depending on the direction of price movements. However, in the long run, a stock price tracks the earnings of the underlying business or what we popularly know as "business fundamentals".

In case one still has doubts, all one has to do is look at the price of Telco over a period of time. The great bull market of 1999-2000 barely had an impact on Telco's stock price, which continued to plunge with its sharply declining earnings.

Or for that matter take a look at the price earnings dance of Infosys.

This behaviour pattern of the market is unlikely to change so long as we human beings make up the market. What is critical for an investor or a trader is to distinguish the short-term and long-term effects on stock prices and act accordingly.

An investor with a long-term view cannot afford to get carried away by the impact of news on a stock price, just as a trader can ill afford to trade for the following fortnight based on what the earnings of the business would be for the following year.

The other home truth on stock price behaviour to remember is that even in the short term the market is right about the impact of an event. However, the magnitude of the impact and its timing are the crucial elements that a successful trader/investor needs to keep in mind. Hence "price" and "timing" are always critical elements of any trading or investing strategy!

For a trader, "timing" assumes priority over "price" whereas for the investor, it is "price" that is important. Of course many of you would have figured out why. Next time we shall look at these two critical elements in greater detail.

Article 15: I will thrive! Can you?

("I can survive, I have and I will." Wondering what we are doing making such aggressive statemen...)

I was having a peaceful nap when I was rudely woken up?

I got up rubbing my eyes to hear many cries of "July 2, 2001"

July 2? I strained my ears to listen to people who have always been under my shade expressing concerns. It looked like they saw no future and had no option to do anything about it. They sure were lamenting!

I cupped my ears to hear well. They feared that no 'badla' and introduction of options and futures was meant to destroy the market, ie cut my roots! Surprisingly, they were not shedding a tear for me but were worried about the fact that they will no longer have the shade! How self-centred can one get!

I opened my eyes wide enough to look at who were actually wailing. They all were fat people who had merely played under my shade and at times hurt my roots. In fact, they made use of a creeper 'badla' to climb up and dance on my slender branches that were meant to further

my growth.

But let me assure I have been around for a very long time. I have seen many people come under my shade, and fruits have grown every season on my branches.

Oh! Before you confuse me for a giant mango tree and wonder what am I doing here in Sharekhan School, let me introduce myself. I am the "Indian stock market"

I am over 200 years old and possibly the oldest one in Asia. My initial history is obscure. The English (East India Company), who came to India to trade, planted the seeds of my future. By 1840 (a good 160 years back), there were registered companies trading in the market with half a dozen recognised brokers. By 1860, there were 60 brokers!

In fact, the first stock market mania in India happened then. The civil war broke out in the US and India was the only supplier of cotton to the world! By 1861, there were 250 brokers J. Guess what happened next? The civil war ended in 1865 and there was a big slump in the market. The Bank of Bombay share, which traded at a princely price of Rs2,850 crashed to Rs87 in no time.

I survived that mania and God knows how many more after that?

After the slump, the brokers decided to regulate themselves. As a first step, they moved in together to stay as a flock on one street--that street is today known as "Dalal Street". Year 1899 is when the Bombay Stock Exchange was formed.

You must have come here hoping to learn something and I have been just rambling. Without much ado, here are some facts and figures that I shall use to make a few points to you today. Here is a comparison of statistics in 1946, the earliest available statistic and statistics for 1995, the latest available. I know 1995 is still outdated but it helps make my point.

	1946	2000	CAGR
Capital of listed Companies (Nominal) (Rs. Crs)	279	59583	11.32%
Capital of listed Companies (adj Inflation) (Rs. crs)	4431	59583	5.33%
Market Value of Capital listed (Nominal) (Rs. crs)	970	478121	13.20%
Mkt Value of Capital listed (adj inflation) (Rs. crs)	15919	478121	7.04%
No. of listed companies	1125	8593	4.15%
Capital per listed Co. (Nominal) (Rs. lakhs)	25	693	6.89%
Capital per listed co. (adj Infl) (Rs. lakhs)	407	693	1.07%
Market Value per listed co. (Nominal) (Rs. lakhs)	86	5564	8.69%
Market Value per listed co. (adj inflation) (Rs. lakhs)	1415	5564	2.78%

The number of listed companies is up eight times in 50 years. Inflation adjusted for these fifty years, the capital raised is up 13 times while the market capitalisation is up a good 30 times.

Isn't it a sign that I have done very well over these years serving corporates that hope to

raise capital for their businesses as well as investors who invest in these companies?

Of course, in the interim period, most of the originally listed stocks have all disappeared, but the fact that investors who managed to pick the survivors every time would have made 8.69% per annum return or 2.78% inflation adjusted return.

That's not much, you would say? Well, if you had invested Rs1,000 in 1946 it would have been Rs65,000 after fifty years. But Rs1,000 fifty years back is not equal to Rs1,000 today. In fact, what Rs1,000 was worth fifty years back would be worth Rs16,000 today. Even then, it would have quadrupled.

Can you think of any other way you could have done this over the last fifty years when this country saw an average inflation of 6%? Apart from the last ten years, India ever since Independence followed a socialistic path that stunted my prosperity.

True that there is no guarantee that any institution that has survived for over 200 years will necessarily survive the next 200. After all, even the great civilisations that we read about in our history books came to an end. Why else would they be in a history book? J

But I have been changing. Derivatives are another way that will help me to serve my purpose better. It has worked in stock markets across. Mind you, it is nothing new here too. We used to have 'Joota' and 'Phatak' here.

What has changed is that there is a lot more science now. Black & Scholes worked out a formula for pricing 'options' that is complex sure but in the world of technology you have calculators that just fetch the price for you.

After all, I did exist before people knew 'P/E' and I existed before people discovered 'PEG' too. How long has it been since Ben Graham worked out a classic style of investing or a Phil Fisher evolved his own style of investing?

These are all examples of investors evolving to make better investing decisions that help them create wealth for themselves on a consistent basis.

We all need to evolve. I am changing for the better. Earlier, investors had to invest and manage the uncertainty of their investments in the same place. Spotting the dilemma of the investor, speculators came up. Initially, it was a symbiotic relationship till the balance broke. Obviously, with little at stake compared to an investor, the speculator made merry.

The investors scurried for cover. But when the investors started disappearing, without them the speculators had to feed on each other and thus their race started dwindling. After all, the investors who were the very basis of their existence disappeared. L

They offered to move to the neighbouring compound in order to allow the investors to thrive and thus was born the derivatives market. In case you are wondering who does the balancing act now, well they are called arbitrageurs.

I am evolving! Are you? If you have no intentions, please don't wail either. Just pack your bags and don't waste my time.

You are keen to evolve? I am very happy and you are my friend. Come let us prosper together.

I rest my case.

Chapter 2: Investor Memoirs
(Share the experiences of many a different investor...)

Article 1: Janus faced volatility
(Understanding how investors and traders come to terms with volatility)

Here is the essence of the wisdom that we have picked up along our journey to this stage.

Stock prices are predictable with larger degree of certainty in the long term

Traders attempt to profit from 'sentiment' and investors profit from the 'fundamentals' of the business

Hence 'trading' and 'investing' need diametrically opposite approaches, attitudes and horizons

Let us begin the next leg of our journey by answering a simple question.

As an investor, which stock would you rather own?

- Stock ABC Ltd. that goes up 100% in year 1, declines 40% in year 2, gains 100% in year 3 and drops 50% in year 4.

- Stock XYZ Ltd. that advances 5% in year 1, rises 5% in year 2, gains 5% in year 3 and increases another 5% in year 4.

Doesn't ABC Ltd. seem the right stock to invest? After all, a simplistic calculation of average returns every year for ABC Ltd works out to 27.5% (200% minus 90% divided by 4). Where as for XYZ Ltd. the average annual returns works out to 5%.

Most of us who wish to be investors make these simplistic calculations and decisions to chase big winners at times without realizing that there is a big risk we take as investors.

Let us assume we invest Rs100 in ABC Ltd. After year 1, the investment goes up to Rs 200. In year 2, it will drop to Rs120 (declines 40%). Year 3 is a good year and the investment grows to Rs 240 (gains 100%). In year 4, the investment in ABC Ltd is worth Rs120 (50% in year 4).

Imagine, you invested Rs 100 in XYZ Ltd. Year 1, it would be worth Rs105. Year 2- Rs110.25, year 3-Rs115.75 and at the end of year 4, you would have made Rs121.5. This way you actually end up making more money than ABC Ltd.

Would it change if you were a trader?

Obviously, yes! Imagine buying ABC Ltd for Rs100 and selling at Rs200 in year 1. Selling short Rs200 worth of ABC in year 2 to make a cool profit of Rs80 (a decline of 40% on Rs200). Then in year 3, buy Rs 280 worth of ABC Ltd and sell it to realize Rs560. Short ABC Ltd in year 4 to make a profit of Rs280. Wow, a cool profit of Rs740.

Whereas in XYZ Ltd, you as a trader would have still made a profit of Rs21.5 L

The learning: Volatility in stock prices presents an opportunity to a trader whereas it is a threat to an investor. Another fact that demonstrates that trading and investing are poles apart.

A short break in our journey to spare a moment understanding how the investor grapples with the threat of volatility. Of course, stretching the horizon of investment helps an investor turn a blind eye to market storms.

There are three active ways of handling volatility. Asset allocation or in other words the way you distribute your wealth between stocks, real estate, gold,fixed income securities (like bonds,deposits) and cash. Portfolio diversification helps handle risk too. Steady investing or spreading investments over a longer time frame is another way of smooth sailing in turbulent market waters.

Time now to prepare a ground to move on?

You are new to the market. You are standing at a junction. You now have these options.

At the primary level, you can either be a trader or an investor.

At the secondary level, you can pick between a stock like ABC Ltd or XYZ Ltd.

Earlier, we have worked out that, as a trader you could have a maximum profit of Rs740 if you were trading **ABC Ltd.** If you were trading **XYZ Ltd.**, you would have earned Rs21.50.

Alternatively, as an investor you would have raked in profits of Rs20 in ABC Ltd and Rs21.5 in XYZ Ltd.

We have represented the profits as a matrix below.

	ABC Ltd.	**XYZ Ltd.**
Investor	20	21.5
Trader	740	21.5

Clearly, the maximum profit of Rs740 trading in a volatile stock like ABC Ltd stands out as the best option. Most new comers to the market make these mental calculations and jump at the option of being a trader in ABC Ltd. J

Is it the right choice?

As Alice would ask `Would you tell me which road leads out of the wood?'

The cardinal mistake most newcomers to the market make is that they assume they are taking the risks of an investor in XYZ Ltd. when they trade in ABC Ltd. in search of the maximum returns. However, we are all a lot more knowledgeable now.

We know how the Janus faced volatility means two different things to the investor and the trader. We also learnt at the beginning of the journey that unpredictable sentiment rules stock prices in the short run whereas predictable business earnings dictates prices in the long run.

Many of you would have already resolved the dilemma. Next time we shall address this in greater detail.

Article 2: Adventures of a novice investor

(Is "how to buy" as much an issue with you as "what to buy"? Some ABCs..).

Once upon a time, when I was in class IX, my parents had my thread ceremony done. I was young (all of 14) and idealistic, so I participated very grudgingly. As a pacifier, my parents let me decide what I wanted to do with the gift money I received.

As I sat scratching my freshly tonsured head, with the princely sum of Rs2000 warming my lap, it occurred to me that I should invest this in the stock market. So I promptly applied for the next IPO that I stumbled on, and as luck would have it, was allotted shares.

The company? XLO Machine Tools. You know how the rest of the story played out, I?m sure. No dividends to date, but I receive balance sheets dripping red ink every year, on the year.

Needless to say, that was the last time my Dad let me have my way with money, for a really long time. I finished college (B Com), worked for a year as a writer in an advertising agency, went to business school to study marketing & advertising, worked in advertising and television for the last 7 years. Neither my B Com nor my MBA gave me any confidence to attempt re-entering the markets. In fact, until I got married, I didn?t save any money, and after I did, my wife took my money and put it in UTI?s MEP, LIC, IDBI?s bonds & so on.

Then I met a friend who works for a stock-broking firm. (Should have his head examined, I thought !) Soon, however, I started reading their research reports. And inevitably, I got hooked. It all sounded so exciting. Infosys should actually be valued at Rs11,000! Lakme gives Rs110 profit in one month! Ramco gives Rs114 profit in 3 days !

All this was too much for me! I had to get on this bus, before I missed another small fortune. But you know how it is. Though I understood that a small investor like me should begin by buying something safe, like Levers or Infosys, I didn?t. I mean, who?s got a couple of lakhs to put in a safe stock like that, right? (Of course, what I didn?t know then, but do know now, is that I could have even bought just 10 shares of Levers if I wanted, since it is a compulsory demat stock).

So I waited for a real bargain. And it wasn?t far away. J K Chemicals at Rs10. Rs 10! A secondary market stock available at par value! And I knew a little about brands and all that, so the Park Avenue story made sense.

I asked around for some names of brokers, picked one who had e-mail (I wasn?t sure what one is supposed to say on the phone, and thought I could avoid getting embarrassed if I e-mailed my orders) and dashed off a note asking him to buy me a 1000 shares of J K Chemicals. And then I waited. And waited. Two whole days went by. My mailbox stayed stubbornly empty.

Meanwhile, I learned that the scrip had scorched away to Rs15 already. Damn, I thought. If only I had ordered 5000 shares instead of 1000. I?d already be richer by Rs25,000. In just two days. Imagine that ! I lost myself in a daydream, buying expensive gifts for everyone, and basked in the warmth of being able to tell my father that my second investment decision in life would more than make up for the first mistake.

The jangle of my colleague?s telephone ringing broke my reverie, and I reluctantly returned to grim reality, and faced up to the awkward task of speaking to my broker. Guess what? He said that I didn?t specify that he should buy J K Chemical at any price possible, so he assumed I wanted it at Rs 10 or below, and he couldn?t get it, so he didn?t. Who was going to tell me that I am supposed to specify all this stuff, I wanted to ask him. What I did ask him was why he didn?t call or mail me to inform me about this for two days running. His answer was simplicity itself. ?

Saab, kam hua nahi, to khali fukat phone kayko karke aapka taim barbaad karoon??

Lesson one in investing. With your instructions to buy, specify whether you want to buy within a particular price limit, or at whatever price the scrip is available. (I believe the jargon for it is limit order or market order, respectively.)

Even more important lesson one. Find a broker who will serve you well, viz., call or e-mail you for clarifications, for information, for confirmations.

You?d think I learnt my lesson and changed my broker. Well, not exactly. Its not like my job leaves me much time to do all this stuff, and he had been recommended by someone I trusted? who was it now?anyway, too much of a bother, so I let it be.

Another story caught my eye. Mastek. Sounded like an Infosys in the making. At a throwaway price of Rs988. Well, not throwaway for me, but it seemed like I wasn?t destined to get a good stock at Rs10, so what the hell, I thought, let?s give it a shot. Of course, I just had Rs50,000 to spare at that time, so I shot off a mail, asking my broker to buy me Rs50,000 worth of Mastek. Remember Levers? You can buy even one share, blah blah blah.

Of course, if you?re wiser than I am at this, dear reader, you know that Mastek isn?t a demat share yet, so I couldn?t have got 50 shares for love or money. This time, my broker did call me to tell me about my folly, but at the end of the day. By which time, as you?ve probably guessed, another bus had left me standing at the stop.

Lesson two in investing. Find out if a scrip is demat before ordering odd numbers of shares.

Never say die is my motto. So, when I read a report on the Polaris public issue, which said it was worth investing in, I enthusiastically got the forms. But the zillion boxes that needed to be filled were too daunting by half. Result? No deal.

By now, you must be thinking I still don?t own a single share, right? Wrong. I finally managed to buy my first stock. Citicorp Securities. No, I didn?t read any research report on this one. My friend at the broking firm said that his gut feel about this stock was very good, they were doing something that Business World did a cover story on, et cetera. Okay, I said. Let?s go for it. And picked it up at Rs250.

Then suddenly one day I woke up to discover that the price had plummeted to Rs210, and it looked like it would keep going south. This, in a market whose index was racing up so fast, Mt. Everest would?ve got a complex. Naturally, I panicked. My friend at the broking firm was suddenly caught up in a whirlwind of meetings, and didn?t respond to the 53 calls I made in 3 days. And here I was, left holding the baby. Frozen into inertia, much like the rat who?s just spotted the raised hood of the cobra towering over him, I did nothing. Fortunately for me, it all worked out in the end, and as soon as it touched Rs 275, I sold the scrip. Of course, I am looking a little foolish, since Citicorp is still riding the up elevator, but doesn?t matter; I saved my skin, right ?

Lesson three in investing. Don?t buy on tips, because tipsters might turn out to be fair weather friends, who scurry into hiding at the first sign of trouble.

Don?t feel sorry for me. I made a killing on the market last week. Let me tell you how. The other day, I went to my ATM to withdraw some money, and saw a notice there that said I could now pay my phone bills, my electricity bills and my credit card bills through the ATM itself. Wow, I said to myself. I work long hours and Saturdays, so it?s almost impossible for me to go to the bank for any work. And know what, ever since I opened an account at HDFC Bank, thanks to

their superb ATM service, I?ve not needed to meet anyone at the bank for anything. I do all my banking in the middle of the night or on a Sunday, without a problem.

Then I got thinking. I tried to remember why I picked HDFC Bank to bank with. Basically for the ATM. But why not any of the other banks which had ATMs? The foreign banks intimidated me, and I?d heard they need huge minimum balances. Between ICICI, IDBI & HDFC, the first two smelled of government, so I wasn?t too confident of their customer service orientation. Whereas, HDFC had been serving middle-class people like me for many years, financing our homes.

When the machine spat out my crisp 500 rupee notes, my flashback ended. And I thought, all the reasons I picked HDFC as the bank to bank to with, are equally good reasons for buying into their business. Then I looked to see if any broker had any research on it. (See lesson three). After finding a report that confirmed my faith in the stock, I bought at Rs87 last week. And it?s already at Rs99. So, all?s well that ends well. My adventures in investing have taught me a lot. And whetted my appetite for more. To me now it?s not so much a pursuit of wealth, though that?s part of the agenda. It?s more a process, a journey, an exploration and a learning experience. In the bargain, if I make some money, that?s icing on the cake.

What are you waiting for? Come, join the adventure!

Article 3: Mangoes vs potatoes

(Why are mangoes costlier than potatoes? Boy! Oh, boy! That is a real tough one)

The other day I took my 6-year-old son shopping. He is at that age where he asks questions which stump fathers the world over. After running through my better half?s shopping list, we headed back to the car. No sooner had I fastened the seatbelts he piped up in his Why is tone: ?Dad, why is a kg of mangoes costlier than a kg of potatoes??

Boy oh Boy. That is a real tough one. ?Son, it costs more to grow the mangoes than it does to grow the potatoes.? Even as those words slipped out of my mouth, I remembered my management textbooks. The producer sets the price based on what the consumer is willing to pay. The consumer pays based on the utility, satisfaction and pleasure that he gets out of the product.

All about utility, satisfaction...and pleasure

So it cannot just be the cost of production that makes the price of mangoes higher than that of potatoes. Come to think of it....that?s true in the stock market as well. Why does Infosys trade at Rs7000 and ICICI Bank at Rs36. They are as different from each other as mangoes are from potatoes. Would you go home with a sackful of potatoes, instead of a basket of mangoes, just because they cost less per kg. Unlikely, In fact, I would wager that you would never dream of doing any such thing.

Then again, you might--if you are a miser. But would you and your family get the same utility and satisfaction? Not to forget pleasure?

It is quite the same thing in the stock market. Rs36 does not make ICICI Bank any cheaper than Infosys at Rs7000. Fine, you might want to buy a Banganapalli instead of a Apoos. If you are from Bombay in all probability you value a Apoos higher (in terms of taste and satisfaction)

than a Banganapalli. So you might pay a higher price for the Apoos.

It?s the same with stocks too

At the end of the day, you pay for the utility value, satisfaction and pleasure that you derive from it. The satisfaction, utility and pleasure that you derive from mangoes cannot be quantified in numbers, at least not easily. Thankfully, in the stock market there are a large number of measures that tell us exactly what we get when we own a share in a company. For example, you can look at the Earnings Per Share (EPS), i.e., the profit earned by the company/per share. That?ll tell you how much of the company?s profits belong to you as the owner of a single share.

You can also look at the Book Value Per Share (BV). That is nothing but the company?s Net Worth (funds which belong to the shareholders as opposed to the debt it might have taken) attributable to each share. How much the company earns on your money is another benchmark. That is Return on Net Worth (RONW). Very simply, it is EPS/BV. After all, if a company has a RONW of just 10%, it means it is just about matching the return you could get by putting your money in a plain vanilla fixed deposit with a bank.

Let me spell out what I am getting at. Do not presume that something is cheaper, and therefore better, just because its price is lower. You need to look beyond the price to see what is it that you get for the amount that you are paying.

The root cause of this perception problem is the concept of par value. I have heard this argument before. Why should I pay Rs7000 to buy a share of Infosys. The par value is only Rs10. Why not buy ICICI Bank? Its par value is the same and its price is only Rs36.

Let me counter. Of what relevance is the par value to you? Nothing. If the company goes bankrupt, is that a guaranteed amount that is returnable to you? NO. Sure, companies still announce dividends based on a percentage of their par value, but is that why you really buy shares? To earn a dividend?

Who are you kidding? You buy it for capital appreciation

Don?t let high stock prices bring you down

Think of a share as representing a certain percentage of the company. If a company has issued 100 shares and you own 1 share, then your share represents a 1% ownership of the company. Sure, in most cases the shares we own make a meaningful percentage only if you go down to the 5th decimal place. But that is what is relevant. How much do you think the company is worth and how much would you pay for acquiring a certain percentage share of it? Think of it that way and things will fall into perspective.

The fruit seller in the market had a basket of mangoes which cost Rs100. I could either pay the fruit seller Rs100 by giving her a hundred rupee note or with two 50 rupee notes. Better still, I could pay her Rs50 and buy half the basket. And somebody else could pay her Rs50 and buy the other half. But that doesn?t make the mangoes any cheaper for me or the other guy, does it?

Let?s put it another way. Say a company is worth Rs100 and you wished to buy 5% of that company. It would cost your Rs5. If the company had 100 shares outstanding, then that would place the value per share at Re1. You would then have to buy 5 shares to buy 5% of

the company. Now let?s presume that a company has only 50 shares outstandings. Now that would place the value per share at Rs2. You would have to buy 2.5 shares of the company, entailing an outlay of Rs5 yet again. In both cases, you just spent Rs5 to buy 5% of the company. So, was it any cheaper to pay Re1 per share than it was to pay Rs2.5 per share?

I can hear my son again: ?Why is a kg of mangoes costlier than a kg of potatoes?? Still need to find some way of explaining this to him!

Article 4: Beware the tipsters

(Some true stories about how people lost money because they got carried away. But learn from mis...)

August 25,1999: The telephone rings in **Vishal?s** office. Vishal is a chartered accountant with a small time finance firm. Vishal answers the phone and listens to the excited voice of **Vaibhav**, his school time buddy who regularly trades in the stock market. Vaibhav peddles stock tips. A few months back, he had called up Vishal and asked him to buy Himachal Futuristic Communications, Global Telesystems and BPL. Vishal refused to act on his advice. Since then, Vaibhav had called up a number of times to remind him that his tips had turned three-baggers! Vishal regretted missing out on these ?get rich quick? tips, especially since everybody in his office spoke about all their multi-baggers everyday!

Vishal: ?Hi Vaibhav, Kya kar...? (before he completes his sentence Vaibhav interrupts in an excited tone)

Vaibhav: ?Aditya Forge, Kunal Overseas aur Jaidka Industries le le. Don?t worry about your missed chances; these three will more than make up for them. Chalo baad mein baat karta hoon? (He slams the receiver down)

Vishal gently places the phone down, caught in a whirlpool of thoughts. He bites his nails as he ruminates whether to buy these hot tips or not. After half an hour, he decides to call his broker. Just as he reaches for the phone, the receptionist in his office calls up to announce that his brother Ramesh is here.

Ramesh was an avid stockmarket participant in the heydays of the early 1990s. After the scam, he lost his last penny. Ramesh ended up owning a lot of penny stocks, which were not worth the paper they were printed on. Ramesh went through very tough times when he had to move with his family to his father?s place. He had to sell off his car and 3 bedroom flat in Bandra, Mumbai. His wife had to take up a job as a secretary in an Ad agency. Ramesh started working as a clerk in a bank...

Vishal: ?Bhaiyya, good that you came. Remember I was telling you about that school buddy of mine, Vaibhav, who claims to have made lot of money in stocks. Well, he keeps calling up to give me stock tips. I refused to act on his earlier calls but they have all multiplied. He had called up just a few minutes back asking me to buy Aditya Forge, Kunal Overseas and Jaidka Industries. I always remembered your experience so I held back, but then I seemed to have missed out. Bhaiyya, advise me.

Ramesh: ?Reminds me of the good old days in 1992. I used to trade on tips too. When the market was going up, all these stocks were going up five times. I had quite a few stocks, like Karnataka Ball Bearings, Mazda Leasing, lots of NBFC stocks. At the peak of the market, my portfolio was worth Rs40lac. I then borrowed money against these stocks and bought more. In fact, I had bought Aditya Forge and Jaidka Foods (Industries now!) then based on tips I had got.?

Vishal: ?Bhaiyya, then what happened??

Ramesh: ?The scam broke out and all hell broke loose. My portfolio, which was worth over Rs40lac, reduced to Rs4lac in just a month. There were no buyers in my stocks. I had borrowed Rs10lac and I had no money to pay. I tried selling my flat but there were no takers. I was saddled with stocks of companies that I knew nothing about. After I paid off my debtors, I tried getting a number of these stocks transferred in my name so that I could sell them when times got better. Much to my dismay, I discovered that many of them did not have offices and were shell companies. I had bought Aditya Forge at Rs26 on a hot tip and found that I had created the top, while it currently trades at Rs2! Jaidka Foods dropped all the way from Rs40 to Rs1.40.?

Vishal: ?You have started trading again. What do you advise me?? Ramesh: ?Vishal, these days I invest. I am really not bothered about the Sensex level, but I probe deeply into the companies that I invest in?their management, their business and future prospects. I buy specific stocks that I understand and I believe are undervalued.?

Vishal: ?But those stocks offer very very gradual appreciation.?

Ramesh: Not at all, Vishal. My portfolio of fundamentally strong stocks has done quite well for me. I bought Zuari Agro at Rs69 fifteen days back and the stock has doubled since then. Many of the stocks have gone up faster than I expected?Tata Honeywell has nearly doubled since I bought it two months back and so has Indo Gulf Corporation. Very often, I too get good information about a company; but you must always cross-check the information. You may listen to tips, but understand very clearly that you need to understand the details of the company yourself.?

Vishal: ?But Vaibhav is a good friend of mine.?

Ramesh: ?If you are to follow Vaibhav?s advice, then you need to at least check how much research Vaibhav himself does before recommending a stock Most tipsters are fair weather friends who are around whenever markets are buoyant, palming off their tips. However, when it is crunch time they all disappear, leaving you stuck with all the dirty stocks. I have had this experience before. Remember, the market thrives on two basic human emotions?greed and fear. Always learn to strike a balance and do your homework. If you are so keen to invest, I will put you on to this brokerage house that offers very sound advice...?

Vishal: ?That would be very useful.?

Ramesh: ?Vishal, I have been through very trying times investing on tips. So don?t let there be another such occurrence in the family. Papa invested in teak farms and you know the state of his finances. Kaka chased those ?time share? investments and lost out. There is nothing like ? get rich quick?. It is usually ?get rich quick, get poorer quicker?.?

(While this story is a piece of fiction, some of the stocks mentioned in this story were actually bought by people in this office way back in 1994. We all get carried away; but to not learn from our experiences is criminal. Many of the people in this office who bought some of the above mentioned stocks are now much more sober, if not wiser, and thought they should share their experiences with you.)

Article 5: You've come a long way, baby

(Today's shareholder has a far greater say in his company. And AGMs provide just the right platf...)

The last five years may have been frustrating years for stock market participants as they witnessed large scale evaporation of inflated wealth. However, there?s a lot of good that has come out of these excruciating times. The markets have evolved to become more efficient, transparent and liquid. Indian corporates that took the investors for a ride have been forced to eat humble pie. Investors who got short changed have since woken up to reality and have learnt to fight for their rights.

Annual Shareholder Meetings of corporates, AGMs as they are popularly known, provide excellent opportunities to understand companies, management and shareholders. AGMs over the last five years have been a great vantage point to observe and understand the Indian stock markets, investors and corporates coming of age.

Through the eyes of Ms. Ashalata Maheshwari.

Ms. Ashalata Maheshwari is an old lady who has been a shareholder in many of India?s family run companies. She religiously attends all AGMs and makes it a point to be one of the first people to walk up to the podium to pose questions to the board of directors. So much so, that today she is an integral part of AGM folklore and the first thing that the Chairmen of these companies do is to scan the crowd to find her and give a smile of recognition.

July 1995

(Corporate results were on the rise, FIIs had just debuted, the IPO market was booming)

Ashalataji: Chairman Saab, Hamara reserves has grown. You should declare a liberal bonus to please shareholders?your staff made me wait for five minutes outside. The sweets being served got exhausted too soon. You should get more next time?

Chairman: Ashalataji, we just declared a bonus last year. As for the rest, I will request the secretarial department to look at it.

July 1996

(Corporates had just declared record profits. Equity research had gained currency on a large scale. Stock markets were range bound with the large number of IPOs taking its toll on small cap stocks)

Ashalataji: I would like to congratulate the Chairman for the superb performance. Hamara company ka ?eps? is very good but our P/E is lower than last year. What is the FII holding in our company? We should increase our FII ceiling. After such a good performance, Chairman Saab, you should declare a bonus?

Chairman: (A large smile on his face) Our FII holding stands at 19% compared to 5% last year. We have organised an analyst meet next month. We are in the midst of a major capacity

expansion and cannot afford equity dilution?

July 1997:

(Inflation taming had led to a Liquidity squeeze, trapping corporates. FIIs had seen their investments erode. The Reliances and Telcos had fallen sharply. Investors had stopped looking at ?Bhav Copies?.)

Ashalataji: Chairman Saab, Why has our share price fallen by 40%? Is our new plant operational? Why don?t you organise a plant visit? By the way, we did a good thing by not declaring a bonus. Our share price would have gone down further!

Chairman: (visibly perturbed by the tough times) We have increased market share in these trying times. Our plant commissioning has been delayed by few months and the project cost is higher than estimated. Our borrowing costs have increased while demand has not picked up yet (As usual, circumstances were blamed) Hopefully things should improve by the end of the year (Hope!)

July 1998:

(A new BJP government had not improved the situation. Industrial Sector had barely managed to grow in the previous year. Post the South East Asian Crisis and post Pokhran, the FIIs had dumped stocks. Shareholder wealth had been eroded) Ashalataji: (A furrowed forehead) Chairman Saab, We have performed very badly. If our cement and sponge iron business is not doing well, why should we have it? Hamara ?core competency? hai textiles (?) Our market share has gone down. Who is our competiton? This years annual report, pg no. 38 shows travelling expenses doubling, pg no. 36 our sundry debtors have increased by 50%. Aur Chairman Saab, aapne tho employee salaries increase kiya hai, lekin our dividend has not gone up...

Chairman: (A forlorn face and at a complete loss of words) Ashalataji, our country has been in a recession. We should be seeing a recovery soon. (Going on the defensive) We have done well against stiff local competition. We are only getting hurt by cheap imports from Taiwan. (Uncomfortable answering the remaining queries, the Chairman quickly turns to another questioner)

July 1999:

(As 1998 turned out to be difficult, corporates paid through the nose to hire consultants. They recommended focus on core competency, selling off unrelated businesses (Where have we heard that before ?) Survival instincts forced corporates to shape up. Recession had halted capacity addition. Banks were flush with liquidity while NPAs grew.)

Ashalataji: (Forgiving mood) Chairman Saab, our cost cutting measures seem to have paid off. Aapko badhaiyan.. Thank you for the plant visit. Our plant is very impressive. I agree with your statement in the annual report (actually penned by the consultant) that we need to focus on our core competency and build a brand equity by adding value to our products. (She has rehearsed this!). Dear Chairman, we should disclose in our annual report our EVA and

the historic Return on Equity. We should also adopt GAAP. Our annual report should also disclose information on the company?s long-term vision and strategy. Sir, Hammne Kargil ke liye big donation kyon nahin kiya hai...(social responsibility of corporates!)

Chairman: (After a quick discussion with his fellow board members) Ashalataji, you are absolutely right. We have decided to give one day?s profits to the Army. You are also right on the EVA, from the current year our business performance will be benchmarked on EVA basis. Next year,we will also report results as per US GAAP.

The Indian Investor has arrived, the corporates are catching up?

Article 6: The Key

(Tune in to find out what an old Buddhist saying has got to do with investment philosophy)

To every person is given the key to the gates of Heaven; the same key opens the gates of Hell - an old Buddhist saying

You may want to rightly raise your finger at me and ask the question - what does this have to do with equities, with the stock market?

We hear stories every day about people, flesh and blood human beings - our clients who have lost money in the recent crash. And I hear many questions. Is the stock market a gamblers den? Can one actually make money? Is it for the individual investor? Given the kind of volatility one has seen in the market does it really make sense to invest in the market for a long term?

In a sense equities are like the key in the saying
I need not remind you that equities as a class provide a much higher rate of return than fixed return instruments. It is the key to immense wealth creation. But use the key wrongly and with the wrong objective and you can find yourself opening the gates to an investor's version of hell.

What we need to do is distinguish between the gates of Hell and the gates of Heaven. And learn how to use the key correctly. Because using it correctly ensures that we find ourselves in front of the correct gate.

From a distance the **gate to Hell is arguably more attractive** - it promises quick returns based on speculative and 'Inside' information resulting in gain without pain. It is with good reason that this gate is more attractive, because what lies behind it is pain. The pain that comes when you realize that you acted on a whim and the anguish you feel when you have to square up your position because you cannot foot the margin.

The **gate to Heaven is far more unattractive**- it is Grey in colour, places a premium on discipline and diligence and promises no short cuts. It promises happiness but does not promise that there will **be no pain along the way**.

Invariably this is where we falter. The correct use of the key in an attempt to open the gate leading to paradise does not mean that you will experience no pain. But that does not mean that you throw away the key or walk over to the gates to hell.

But why should there be pain on the way to heaven? Simple - the higher rewards that the use of this key brings. It is the premium you earn for taking on additional risk, for deciding to accept and put up with pain (think volatility) in an attempt to make it to heaven.

Our own portfolios have faced the heat of this meltdown with the **Hammock** losing 26.80% and the **Hot Chocolate** losing 43.15% since their launch in early April. But we believe we are using

the key correctly. We reiterate these principles regularly in our School section. Because we want you to understand how to use the key as well.

We face the pain just as you do. But the gate to paradise never promised that there would be no pain along the way. As long as we use the key rightly and focus on the correct door we will find our heaven.

Article 7: Soul-searching time

(Time to clean up the skeletons in the cupboard...)

The stock market is governed by two forces - fear and greed.

And it doesn't take much to figure out that fear is the dominant force these days. It's not a happy feeling that I experience when I pull out my portfolio every morning and calculate the damage. Afraid is what I feel. And with fear comes denial. I'd rather not look at my portfolio at all. For it hurts to even to look at it sometimes.

But look you must. And you must ask yourself some hard questions too.

How much of the damage is of my own doing?

- Did I buy the wrong stocks (at wrong price)?
- Did I buy the right stocks (at right price)?
- Did I buy the right stocks (at wrong price)?
- Did I commit the mistake of not selling when the stock got dear?

The answers will determine your future course of action. Getting rid of the wrong stocks will give you the cash to buy the right stocks (which you bought at the wrong price) at a reduced price. As for the right stocks, even if these do trade at lower prices, there is no cause for worry.

And what if you realise that you should have sold some stocks at higher prices when the opportunity presented itself earlier? Ah, that's a tricky one! The way to solve this problem is to ask yourself another question - If I did not hold this stock and had some ready cash, would I still buy the same stock? The answer to that question will tell you what to do.

So, go ahead and ask yourself those tough questions. Running from your portfolio won't help!

Article 8: Back to basics

(Coming to terms with the simplest truth of investing)

Investing in equities is akin to owning a business
We all know this, right ? Yet, most investors I meet seem to have forgotten this basic fact. But I don't blame them.

After all, 80% of the daily traded volumes at both exchanges is concentrated in 10 volatile stocks. And actual deliveries (transactions which are settled by delivering stock or money) amount to less than 25 % of traded volumes.

Meanwhile, the investor is being inundated with news of how the FIIs did this and the Nasdaq did that. How the Big bull is ramping up xyz stock or that the No.1 Market-maker is holidaying in the Bahamas and that is the reason for inactivity in the market.

Groggy from this overdose of news and rumours, it is easy to forget that Investing in equity is akin to owning a business.

When you buy shares in a company, you are providing capital for the company, which is represented by an equity share. You are participating in the ownership of the company. Clearly the risks are high, because you are entrusting the company (the management) with the job of managing the business for you.

Once you look at it this way, things fall into place. Figuring out which company to invest your money in is no different from the process you would adopt when getting into business yourself.

How would you go about identifying which business you want to be in?
For starters, it should display the potential to earn you a return in excess of what the prevailing rate of bank interest is, right? But that is not enough, is it?

You would want the business to earn a return far higher than that for it to be worth your while. And you would want those returns to be consistent. After all who wants to run a business in which one year there is a pot of gold and the next a gaping hole. Consistency counts if the home fires are to be kept burning.

The ideal business would thus be one where profits can be sustained over a long term. There are many external factors that will determine the direction and growth of the business. And you would like to be in a business where you understand these factors, bring certain key strength and skills that will help you face up to the challenges peculiar to the business and not have to deal with too many factors which are completely out of your control.

Of course, on an ongoing basis, you would definitely want to evaluate the performance of your business. Operations would have to be evaluated from market feedback, while the financial statements would give a view of the profitability of the concern.

The same concepts apply to stocks
Now, here's the punch line. Everything we discussed above doesn't apply only to running a business. The same concepts apply, even if you just own shares in the company.

The common question that pops up in this context is: "How do I externally control the business if I do not have a say in the management?".

Ok, let's assume that you are now running the business you chose. Can you, a single individual, handle all functions of the company? For a while, maybe. But once growth sets in, it would be humanly impossible to manage all the functions of an economic activity, viz. marketing, finance, procurement, etc. That's when your business will need to morph from one-man outfit to organization status. Wherein the various functions are distributed across individuals, and finally the same is translated into a unified activity.

Similarly, as a shareholder, you end up delegating authority to others to run the organisation you have a stake in. Imagine Mr Narayana Murthy (Infosys), Mr Manvinder Singh Banga (HLL) and Mr Anji Reddy (Dr Reddy's) reporting to you. That's exactly how the cookie crumbles.

The company whose equity you have participated in is answerable. To you, as well as other shareholders of the company. Thus, while you as a joint owner have delegated the operations of the company to the professional managers and the employees, the management in turn is responsible to its shareholders. The management communicates through the balance sheet and the AGM, where shareholders voice their opinion on the performance of the company.

Unfortunately, investors seem to forget this. I know a smart businessman from Jullundar who is very careful about who he does business with and doesn't like to take any credit risk. Yet, he doesn't think twice before investing his hard earned money in a company whose balance sheet is full of holes and whose payment track record leaves much to be desired.

Why? Well their p/e is lower than that of the Industry leader. Hmmm.

Or the honest school teacher from Ahmedabad who reads Dr Radhakrishnan by night and invests her savings in a company whose management, is, well, not quite straight. She bought into the company because her colleague's brother who happens to work with this large broker in Bombay tipped her off on what a certain FII is going to buy today. It was to be a quick buck. In and out before you know it. It has been 8 months since then.

Chew on that, while I drum up some more investor anecdotes for you.

Article 9: Financial Resolutions for the New Year

(The ten resolutions a serious investor like you should be making for the New Year...)

On the stock markets, Y2K has been quite a roller coaster of a year. The wild ride up to the highs of February and then the plunge - that practically never stopped. I am reminded of the classic film - 'Never Ending Story.' (Maybe you should watch it? anything to get your mind off this bruising market J).

In a strange way, the October - December patch of 2000 was quite reminiscent of the December 1999-February 2000 period. I am sure you remember that time.

Every day the newspaper headlines were dominated by positive stories. Mr.Premji was getting richer everyday, Nasscom's projected figures for software exports from India were sounding rosier by the minute, Indians were making it really big in Silicon Valley and the Nasdaq was defying gravity.

It was a time when making money was very easy. You just had to be there and buy something, anything. It turned into gold. It was unreal.

Now it's the same. Except for one big difference.

Everything you own is turning into clay. The good, the bad and the ugly are being treated with equal disdain. It does not matter if your company has reported a 50% jump in profits or a 300% jump. It does not matter if they exude confidence about the future. The newspaper headlines rule again - Dow cracks, Nasdaq falls, Industrial growth slows, S& P downgrades, Middle East crisis... The cup of woes is truly overflowing.

Just as there was a lack of discerning judgment in the heydays, there is a similar lack of discerning judgment today.

On the bright side, such times rarely last. And this too shall pass.

What's more, trying times like these are a great opportunity for you to take stock of your investment strategy and portfolio philosophy.

To ensure that you do not repeat the mistakes of the past, here are some principles that you would do well to remember and follow - through the good times and the bad times. You might even see them as your own list of **10 Commandments for Profitable Investing.**

Always think Portfolio

Investing in the stock market is about owning a basket of stocks. It is not about owning just one hot stock. So always look at buying more than one. In that process you may end up with 5, 10 or even 50 stocks. In the course of my practice, I have come across people who own as many as 500 stocks in their portfolios! What's the right number? Hold on just a while longer and I'll get to that point.

Diversification is the name of the game

The objective of the Portfolio approach is to diversify risk. You might want to ask me at this point - does a portfolio consisting of only 10 (for the sake of argument) steel companies constitute a good portfolio (or 10 software companies for that matter)?

The emphatic answer to such a question is, No. The portfolio approach calls for diversification. And you do not achieve that when you own a portfolio of just 10 steel (or software) companies. The factors that affect the steel (or software) business will take their toll on each of the steel (or software) companies in your portfolio.

Even the market risk does not get spread out. Hence, this portfolio is as risky as the one with just one steel company. It fails because there is no diversification across various businesses. But remember that diversification is the means to an end (returns), it is not an end in itself.

Focus, Focus, Focus?

In the pursuit of the noble objective of diversification don't spread your net (portfolio) too

wide; otherwise it will become unwieldy to manage. Also remember that there is a trade-off between risks and returns. As the number of stocks keeps increasing, not only does the portfolio become unmanageable, it begins to reduce your returns! In medical terms, too many pills can have undesirable side effects!

As a rule, I would recommend that the number of stocks in a portfolio should never be more than 15. It is quite difficult to keep track of a large number of companies. Sure enough, just when you are not looking one of them will punch a deep hole in the portfolio.

Also, do the arithmetic: if a stock accounts for just 1% of your portfolio and it doubles, your portfolio return goes up by just 1%. Hardly anything to get excited about!

There's no such thing as a free lunch

There is no such thing as low risk with high return. I hate to disappoint you, but that is the truth. There are no magic pills. You cannot "have your cake and eat it too". A portfolio is always a trade-off between risk and return. Building a Portfolio is all about balancing these two opposite forces. It is about optimising returns, given a risk profile and an investment horizon. Hence, it is important that you understand your risk profile before creating a portfolio.

Seasonality never pays

I know a lot of people who turned off the equity market during the period 1995-1999. After sitting out the best part of a 15-month rally that lasted up to Feb2000, they decided to jump in just at the wrong time. Look no further than Mutual fund collections in the first quarter of this calendar. They surged to levels not seen in the past 5 years.

Just as you need to earn money every month to keep the home fires burning, you must save money on a regular basis. And importantly invest that money in equities on a regular basis.

Most investors tend to fall victim to the volatility. Buying only when everybody is talking about the market and the headlines are unambiguously bullish. And selling out of equities when the bearish crescendo reaches a new high (or should I say low).

Don't fall victim to the volatility that is part and parcel of the stock market. Instead use the volatility to your favour - invest consistently and steadily through all swings and seasons. Investing in equity is as much of a regular activity as brushing your teeth is.

Get in for the long haul

Investing is all about time in the market, not 'timing' the market. It is very difficult to accurately and consistently picks market bottoms and tops. In fact some would argue it is futile. The 'experts' will frequently fall flat when it comes to forecasting tops and bottoms (yours truly included) for the stock market. But the longer the time you spend in the market the less the impact that timing has on your returns.

The smart investors are the ones who understand this and stay in the game for the long haul. The method of rupee cost averaging (wherein you invest a fixed amount of money at regular intervals) delivers returns that are comparable to those you will earn by catching tops and bottoms successfully over the long term. There is a wealth of data and studies to that effect

and any decent financial website will tell you more about the concept of Rupee Cost Averaging.

Speculation? Not for everybody

Never use margin money to buy stocks. You should not invest money you don't have. There is a logical process to our monetary life. First you must earn money, then save some and finally invest it. Just as it is not a good idea to spend everything you earn, it is not a good idea to invest money you don't have (by borrowing).

That by the way is not investing - that is called speculation. Now, speculation can be extremely profitable but it can also be extremely harmful to your financial health. In fact, profitable speculation is a full-time job. So unless you have the requisite skill sets, and are willing to chuck your day job, don't even think about it.

Here's a hot tip for you. (There is no such thing)

There is no alternative to doing the hard work that must be done before making an investment. You must do your own due diligence to determine what is best for you. Do not accept advice from anybody and everybody. And be wary of the so-called hot tips and sure-fire tips. They might seem cheap but they eventually turn out to be pretty expensive.

Equities means ownership

Oh, how often we forget this! The difference between investing money in a business of your own and investing in equities in the stock market is?

Zilch. That's right, there is absolutely no difference. Just as you would need to hire a bunch of managers to help you manage your business, when you own shares in a company you have outsourced the management function to the incumbent management of that company.

Would you hire somebody you don't trust as a manager in your company? I can't see why you would. So why invest in a company whose management you can't trust?

Would you invest in your business if it were not growing, if it were not earning you a return of at least 20-21% on the capital invested? Unlikely isn't it? Don't drop the bar when you screen the stock market for companies to invest in.

There are no tricks to investing

The trick to being a successful investor is no trick at all. It is all about discipline. In fact successful investing is 99% discipline and 1% everything else. It not just about remembering the 9 principles that I just laid out, it is about having the discipline to stick by them, through thick and thin.

Article 10: Vision + Strategy

(What does Thomas Alva Edison have in common with Azim Premji?)

One of the eternal battles in the media business is over who calls the shots?the delivery medium or the content producer? For example in the Internet business, who will reign supreme?the ISP who provides you Net access or the content provider who provides the matter that makes you sign up for an access service?

Is VSNL (access) or Rediff (content) or Sify (access+content!) going to be the winner of the Internet sweepstakes? But this is a debate older than the author and I have no claim to being able to resolve it satisfactorily. But it brings us to another question.

What do you need to make money in the stock market?the ability to pick winning ideas or the right investment strategy (the science behind your buying, selling decisions and portfolio allocation, management decisions)?

Edison?s famous words?"Genius is 99% perspiration, 1% inspiration"?seem to suggest that strategy and implementation are more important than the throw-a-dart, one-in-a-million stock pick. Our own homegrown achiever, Azim Premji of Wipro, made a thought-provoking statement along similar lines while accepting the Businessman of the Year award. He said, **"Ships are safe in the harbour. But that is not what they are designed for. A vision cannot be safe, strategies must de-risk it."**

If you want to enter the stock market, you must be prepared to leave the harbour. And once you have set sail with your vision of making a strong and loss-resistant portfolio with your stock picking skills, you will need your strategy and its implementation to give it direction.

Strategy issues loom large. You could choose to be a trader with a buy-and-dispose philosophy or an investor with a buy-and-hold approach?and succeed in either role. Implementation of strategy is the key to success. As a trader, you need to align your actions?follow stop losses and don?t overtrade. As an investor, you need to be tenacious?stand by your decisions in the face of many bear hugs to come.

I don?t mean to preach, merely highlight this fact: **A strategy is as important to a project as the vision that drives it. Don?t take it from me?ask the wealthiest man in India, Mr Premji.**

Article 11: No green thumb

(If watering the plants everyday is not your cup of tea then you must search for the plant that ...)

I do not have a green thumb and I make no bones about it. The efforts involved in raising a plant are way too onerous. I don't mind the trip to the nursery and I don't mind the time involved in choosing the plants I'd like to see grow in my balcony. What I hate or rather hate myself for, is my inability to remember to water the plants everyday.

What I really need
I do give it a shot every now and then but invariably the demands made by the plant's constant need for nurturing by way of water and nutrients is beyond my ability to provide. What I have always hoped for is that the biotech revolution will soon pave the way for a sapling that does not need water to grow.

If science has made possible a wrinkle free shirt and pre-faded jeans then why not plants that do not require daily watering?

A self-sustaining plant
If you want to introduce some jargon into the argument at this point-we could call such a plant

a self-sustaining plant. One shot of water the day I bring it home from the nursery and then no more water required. Wouldn't you pay a premium for such a plant? I for one sure would.

It's the same in the stock market
Not surprisingly my willingness to pay a premium for such a self-sustaining plant finds echo in the stock market. After all the stock market is the ultimate market place in which a large number of smart people with differing notions of value constantly seek to find the right price.

A premium
Yes, that's right. Just think company instead of plant. And think equity (financing) instead of water. Companies that visit the stock market to raise funds less often always appear to trade at a premium, as compared to their brethren who visit the market oh so frequently to raise money. And returns earned by owning shares of such companies typically beats that earned from others.

Of course there is more to the premium that one company enjoys over another in the stock market than just its appetite for money but the correlation is sufficiently high enough to suggest that this is an important criterion. In fact the premium that most MNC companies have enjoyed as a group is in large part attributable to their non- recourse to equity funding. It is a different story that in recent years due to their (minority) shareholder unfriendly policies that premium has vastly eroded.

Reliance-a thirsty company
Reliance Industries makes for a fascinating case study of the linkage between returns and self-sustaining growth. Reliance and the capital market cult in India are so closely entwined that it is difficult to separate the history of one from the other.

As the most widely held stock in India the company has done much in terms of furthering the equity cult in India and perhaps this very effort is in turn responsible for their own success.

The company by its own admission tapped the market innumerable times for raising equity between 1978 when it listed and the early 1990s. Its last equity issue was in 1994, a good 7 years ago. But in the intervening period its equity ballooned as a result of a constant spate of rights issues, mergers and overseas issues. Its equity capital ballooned from Rs51cr in FY1985 to Rs462cr in FY1997. It has since risen further to Rs1053cr as a result of a bonus issue and Warrant conversion.

What of the investor?
And how does an investor in Reliance fare as a result? Well over the last 23 years since Reliance went public-not too badly at all.

An investors who invested Rs1,000 (100 sharesxRs10) in the company in 1978 and did not participate in any further issues now holds 512 shares in the company valued in all at Rs1,92,000 (@Rs375) ignoring dividends-an annualized return of 26% pa. A creditable performance that would warm the cockles of a Reliance shareholder and make envious those who do not own it.

Sharp variation
What I however find more interesting is the sharp variation in the returns earned by the shareholders in the dilutive era that prevailed up to FY1995 and the post dilutive era ever since. Reliance's last dilution was an equity issue in 1994, which is recorded in their FY1995 balance sheet. All increases thereafter being due to conversion of previously issued instruments (convertible bonds/warrants). These were outstanding as of the FY1995 balance sheet.

(Trivia-Reliance's last issue in 1994, was a private placement of equity with UTI and other domestic financial institutions, a deal which raked up quite a muck in the press and even in the Parliament)

Splitting the returns
Let's split the return that a shareholder earned during the entire period 1978-2001 into 2 parts. The first part being the return between 1978 and March 1995, marking the balance sheet of the last year in which they diluted equity capital and the second part being the return earned thereafter.

For the purpose of this analysis and for the sake of simplicity I am presuming that this shareholder did not participate in any further offerings by Reliance during the period 1978-2001. Of course he would receive any Bonus shares issued during the period.

The person who bought 100 shares of Reliance with an outlay of Rs1000 in 1978 was the proud owner of 256 shares of Reliance in 1995. In March 1995 Reliance closed at Rs130 and hence the value of the holding amounts to Rs33,280, a compounded return of 23% pa. Good, but note that this return for a 17-year period is lower than the return over the entire 23 year period in spite of accounting for over 2/3 of the period in terms of time.

No more issues
Now if some of you are as ancient as I am you will remember that after the controversy surrounding its equity issue in 1994 Reliance more or less promised that it did not intend to dilute equity in the future. The company has come good on that promise.

It has been 7 years since its last issue-quite remarkable for a company that saw its equity balloon nearly 10x in the 10 year period between 1985-1995 through constant dilution. If you had been wise enough (unlike yours truly) and taken the company's word, bought shares in Reliance in March 1995 then you would be laughing all your way to the bank.

Returns get better
An investment of Rs13,000 in 100 shares of Reliance in March 1995 would be worth Rs75,000 today a compounded return of nearly 34% pa in the last 6 years. In other words the returns earned by buying Reliance in 1995 after it became a self-sustaining company (plant) that required no further equity funding (watering) are nearly 50% higher than the returns earned in the previous 17 years.

Need I say more?
Do you need any more proof that buying self-sustaining companies is far more rewarding than buying companies that need constant daily doses of water and nurturing? In fact the returns of 23% pa in the dilutive era that prevailed up to 1995 are overstated to the extent that in this analysis I have ignored the various rights issues done by the company.

These had a depressive effect on returns because the Reliance share price stayed in fairly wide range during its dilution prone years. You could have sold your 256 shares at Rs130 way back in 1986 if you had chosen to and the incremental investment in Reliance during that period really started to earn positive returns only after 1997.

Buy those who don't need it!
Biotech might not have come so far so as to produce plants that require only one single dose of water (did somebody say cactus?) but in the stock market there are companies that can grow without cash and those that need cash. In a perverse way it is the companies that don't need your cash that are likely to be more rewarding!

Chapter 3: Analyst Memoirs

(Pro analysts share their secrets and more here..).

Article 1: Fear of falling

(Find out how a professional learnt his first lessons in investing way back in time...)

Turn the clock back to 1994.

I am just 24 years old. And my career graph is already looking up. I am recognised as a hotshot research analyst. One day, I am asked to work on two large companies from two diverse sectors - MTNL and SBI.

'Wow!' I enthuse. 'What great companies! Natural monopolies, these. How can anyone ever compete (even if the government allowed them to) with these lovely companies? MTNL has India's two richest cities wired on to its phone network, Bombay and Delhi; and SBI has distribution even where HLL soaps may not be available - it has branches everywhere.'

Which is when one of my client butts in, 'Which bank do you have your personal savings account with? And are you happy with your home phone?"

'Uh,' I mutter. 'It doesn't matter. It doesn't matter because, dear ma'am, we are discussing monopolies here, monopolies with a capital 'M' you see. They are like the classical tollgates. Wanna enter the city? Pay up.'

'I still want my answer,' the client insists.

Some hmmmm, wellll, aaawwww later, I surrender. 'I bank with Citibank (read because I hate to wait at SBI counters and dislike being treated like a convict at a police station). And I would prefer if my phone line would develop faults less often, and when faulty, would get fixed without me having to wait a week.'

'But you see,' I add, 'customers always crib. And how does it matter, they are monopolies!'

Flashback over. Let us come back to the present. Circa April 2000.

SBI is at Rs203 and MTNL at Rs223. Guess what the prices of these stocks were six years back? MTNL was ruling at Rs225 while SBI was at Rs240. Six long years have passed, and lot of earnings growth taken place. But their prices are where these were?ugh! HDFC Bank came into the world in May 1995 at Rs10, and is Rs230 today.

Flashback time again (I love movies you see). This time round, turn the clock back to 1974. I am a kid of five learning to ride a bicycle.

One day, I fall off the cycle and hurt myself in the process. And for days I avoid my bike like the plague. My father cannot stand it any longer. He puts me up on a chair and drills into me, "It is important to experience the fear of falling. Only then will you learn not to repeat mistakes."

Do monopolies have this fear of falling?

They know damn well that customers do not have a choice. They are the tollgates remember. How does it matter if the customers are unhappy?

But the truth is: it matters. Maybe it does not, over the short term. But over a longer term, it does.

Someone out there can see that you are goofing up, that your customers are unhappy. And he will move in to take your lunch away. Maybe by inventing new ways of doing business (ATMs, Internet) or by using new technologies (mobiles, VOIP) etc. Dethrone you, he will.

And the market is smart. Somehow it can see over a longer term. And much before this new thing comes in to punish a monopoly the market gives its verdict.

Fear of falling and the will to stand up and run again is important. And all of us learnt this lesson when we learnt to walk for the first time.

Article 2: Want to buy a stock, talk to your wife

(A pro analyst shares his secrets on 'common sense' investing...)

First let me introduce myself. I am an equity analyst. Been one for the last seven years. And I have not done too bad, if I may say so. I have been able to outperform the Sensex for all these seven years, starting 1993. Well, I had enough reasons to believe that I was the real hotshot stock picker on the street?until of course I discussed stocks with my wife.

Enlightenment happened one fine day, three years back. In August 1997 to be precise. She has heard me often on StarTV Business News. So, that particular day, she asked me to explain the meaning of those fancy jargons that I employ to describe the market's shenanigans. I thought I would impress her (some more) with my knowledge.
After some trouble trying to explain EPS and PE, I decided to enlighten her about how I had beaten the fixed deposit returns and made money for our family, by investing wisely in equities. I also informed her of my investments in Bausch & Lomb. Boasted how I had bought the stock at Rs100, and how we would make oodles of money as contact lenses and Rayban sunglasses are growing businesses.

'Well,' she said, 'Novartis makes better contacts.' Apparently, she had bought their CIBA vision contacts only a week back. 'Look, I don't understand your language, but you should sell Bausch & Lomb and buy Novartis,' she recommended.

'Ha,' I said, 'go back to teaching kids (she teaches 'thinking' skills to school kids).'

Want to know what happened to Bausch & Lomb and Novartis? Over the next 12 months B&L crashed 50% while Novartis doubled.

The million the I missed

Around the same time, trying to recover from this humiliation, and to prove that it was just a fluke, I asked my wife to recommend another stock just to see if her first pick was not a fluke. She asked me to buy Henkel Spic. Why? She had just replaced 'Ariel' with 'Henko' as her washing machine detergent. She said that it gave her the same results at half the price.

'No way,' I said. 'It is a loss making company. And will never make profits.'

No, no, don't even try to hazard a guess - the stock was Rs16 then?and I have lost a three-bagger till date because I refused to act on my wife's advice.

Well, at least I can take pride in saying that I am not stubborn or incorrigible. For few months later (after Henkel had already risen 100%), when she told me that our one year old son consumed only 'Britannia' cheese (and actually rejected 'Amul'), I bought some Britannia stock? and I am up 100% over 26 months.

Now, my better half even has her own top picks. Her three best buys are: first, HLL - she says that you just can't get away from HLL. More than half our kitchen, bathroom and dressing table items come from the HLL stable. Secondly, Zee TV - no, she does not watch TV much. But she does crib that the few hours, which I do spend at home, are all gone watching Zee! And last, Infosys - she does not understand tech. She had watched Narayan Murthy's interview once; she is convinced that the man is sincere, visionary and yet down to earth - recipe for success, according to her.

Takers, anybody?

Article 3: This too will pass

(In a strange way the current depressed market reminds me of February, earlier this year...)

It's been a horrific week
And that's putting it mildly. Wouldn't you give a hand as well as a leg just so that you are able to go to sleep and wake up a month later? Or maybe you would rather not. What if you wake up to find the market even lower? So while your eyes remain focused on the screen, beads of sweat continue to form on your brow and in the background, the only sound you continue to hear is that of your heart beating.

What a year it's been! Remember the highs of January and February and the lows of May? And just when you thought it was safe to go out again -- Part II. It is almost like a conspiracy. All at the same time the Reserve Bank of India and CMIE and even Standard & Poor's wake up and downgrade their outlooks. Thank god for competition -- at least Moody's stood up for us!

In a strange way all this reminds me of the period during December-February, earlier this year. I am sure you remember that time. Every day positive stories would dominate newspaper headlines. Mr Premji was getting richer and Nasscom's projected figures for software exports from India were doing the rounds of the market. Indians were making it big in Silicon Valley and the Nasdaq was defying gravity. Money-making was your birthright. Everything you touched turned into gold. It was so real that it was unreal.

It's unreal again. Only this time it's painful.
The crash into the lows of May had brought you back to earth. The mistakes brought about by a bull market were all too apparent. Salvation could be had if you cleaned your cupboard and stuck to the high ground. With a portfolio of sound companies you could make it out of the trough.

But the trough is beginning to resemble a deep hole in the ground and the way out is not clear. Even the healthy are falling by the wayside. What do you do when a company reports a 135% growth in profits, beats analyst estimates by 9% in the process and yet slips 15% in the end? Sure the company (Infosys) is not cheap -- it trades at a price earnings ratio of 75x on FY2001 earnings. But how can you ignore the fact the company is expected to grow at 75-85% next year. The company is now trading at a price earnings to growth ratio (P/G) of just 1 based on FY2002 earnings. That is cheap. That is attractive. Period.

And that's what makes the current situation unreal. **The market is refusing to discern between good and bad anymore. Just like it was refusing to do so eight months ago.**

The feel-good and the bullish headlines of earlier times have been replaced by an all-pervading depression and stories about earnings warnings, falling global markets and poor economic outlook. And now the Middle East crisis.

It's the same story. Only it's playing the other way round. The good news is being ignored. But

the market cannot stay detached from reality for long. The market cannot ignore the good for long.

This too will pass.

Article 4: Of course I am scared

(Are you thinking of taking *sanyas* from the stock market? Change your plans, dear investor)

When I said that to my closest 'stock-market' confidante, he retorted that I would be inhuman not to be so. That in this kind of a market if I did not worry or indulge in some soul-searching I would be abnormal. According to him I definitely need to ask myself if I am holding the right stocks, I am leveraged and whether I have enough cash in my bank account to pay for the holiday that I am planning to take next month.

I believe I am holding the right stocks, I don't need cash tomorrow, and I am not leveraged. So, why the hell am I hurting so much?

Switch on CNBC, and you hear about a global equity meltdown. Open the pink papers, and doomsday forecasts stare at your face. Resolve fiscal deficit crisis tomorrow, or India is dead. Privatise PSUs next month, or else you will find yourself in a debt crisis. Economy is slipping back into recession. World's leading rating agency S&P has downgraded India.

Oh my god! Should I be shifting all my savings to fixed deposits? But are fixed deposits safe? With this kind of an economic crisis, won't the banks go bankrupt? Maybe my grandfather was right -- capital is safe only in gold and cash should be stashed under the mattress.

Wait a minute! I think I have heard this before.

At least four times in the last six years that I have spent investing in equities. And always around Diwali or towards the end of the year.

In 1995, 1996, 1997 and 1998 to be precise. And each and every time I felt like going back to my father's farms and breathe the fresh village air. I thought the equity market was for gamblers. That India will remain a loser.

Every time I had those dark thoughts the market would bounce back by at least 1500 points, or 60-70%, from the panic levels.

Imagine if I had given in to my deepest fears, swayed by market sentiments, I would have

missed out on the market bouncebacks.

Moral of the story: don't just follow the herd, look for what the herd is doing.

To fight a movement is foolish. But when a movement becomes herd behaviour, jump. In market parlance, buy the rumour and sell the news. When newspapers and magazines (and rating companies?) forecast doomsday, they actually mean that bad days are coming to an end. When you feel like boarding the next train to your village, check the booking positions. If you 'spot' the herd on the train, stay back. Just a while!

Works the other way round too.

Keep a watch on whether your driver is asking for stock-tips. Or everybody on the local train is pouring over stock quotes. Or your old father-in-law, who knew no better way of protecting capital than by stashing cash in the pillows or buying jewelry for his daughter (my wifeJ), begins to put most of his money in stocks.

Article 5: Why read newspapers?

(News headlines can conceal more than they reveal. The devil is always in the details)

Two pens, two colours

It was the start of what was looking to be a depressing day. The Nasdaq composite was down 7% and the market looked set to open sharply lower. But the daily routine calls for a research-sales morning meeting and we got down to business. On my way in to work I read the Times of India, in which there was an article suggesting that Nicholas Piramal was the frontrunner in the race to acquire Rhone Poulenc. Now Nicholas Piramal is one of our Apple Green stocks and when a company does a large acquisition, it is only natural that one take a hard relook at the company.

So the meeting kicked off on that note: What happens to Nicholas Piramal if its bid to take over Rhone Poulenc is successful on the terms being bandied about by the newspaper? No sooner was the topic tabled, a voice popped up: "Don't you mean what happens to Wockhardt if they take over Rhone Poulenc?"

"No, I mean Nicholas Piramal," Yours Truly assured the Voice. And then somebody thrust the Business Standard, which I had not read, in front of my face. It screamed 'Wockhardt, frontrunner in race to acquire Rhone'.

Uh oh! Two different news papers, two different stories. Moral of the story? Read all the newspapers you can.

Discount the grapevine

But seriously. This is the information age. And sometimes, there is more information going around than we need. Some of that information is based on facts, a lot of it is analysis but some is rumours, whispers and what have you. As an investor, you need to exercise care when acting on this information.

Acting on rumours, whispers and information that comes from "sources" can be injurious to investing health, to say the least. Rumours are all too often just that - rumours. Some of them may turn out to be true, but equally often (maybe more often) they will not. It is up to you to exercise discretion.

The devil is in the details

But deciding not to act on rumours and hearsay is the easy part. Unfortunately, even in the case of factually correct information, the way facts are presented can lead to incorrect and misleading conclusions. Delving beyond the headlines becomes very important because of headlines such as these:

'Bhel Q2 net falls 90.69%' - The Economic Times, 2nd November 2000

'BHEL net profit at Rs11.90cr' - Business Line, 2nd November 2000

The second headline is quite innocuous - so much so that you might choose to gloss over it. But the first one is quite an attention grabber and packs quite a punch, doesn't it? And it does make a world of difference, depending on which one you read.

Hence it is very necessary that you delve beyond the headlines to reach your own conclusion and verify the source before you act on it.

The Wipro ADS: from different perspectives

Here's another example. These are the headlines that appeared in the business dailies the day after the Wipro ADR was priced:

'Wipro ADS priced at 14% discount to BSE closing' - Business Standard

'Wipro makes NYSE debut at a premium' - Business Line

'Wipro ADS opens at $44.5 on Wall Street' - Financial Express

'Wipro ADS priced at $41.38, lists at $44.5' - The Economic Times

It makes a world of difference which one you read. The only headline which told you the most materially important point was arguably the first one. And you could have carried away a different picture about the success of the Wipro ADS based on which headline you saw. To be fair, though, reading the entire story (in all the cases) would have presented the most meaningful fact - that the ADS was in fact placed at a discount.

Was that the same story?
Of course, facts can be presented with very different implications and analyses as well. Consider this set of headlines from two different newspapers for the same story.

'Foreign investors invited to help store grain' - The Economic Times

'Govt to export grains at a loss' - Business Standard

Don't get me wrong. I'm not trying to critique the newspapers. It's very likely that if you compare the headlines of the newspapers as well as many websites about the same event you might reach the same conclusion - headlines can be misleading. The devil is in the details.

Not a unique Indian phenomenon, thankfully
This is not even a situation unique to India. Check out this series of headlines about Coke's announcements made on the 20th of December in US papers. This was basically an announcement by Coke that volume growth would be lower than earlier estimates, although earnings would be as expected.

'Coke: Volume Will Make Small Gains' - AP Financial - 6:08pm

'Coke Sees Volume Growth Below Forecasts' - Reuter Business News - 4:44pm

'Coke Warns of Weaker Volume Growth, Reinstates Share Repurchase Program' - The Wall Street Journal Online - 1:50pm

'Coke Sees Q4 Volume Growth Below Some Forecasts' - Reuter Securities - 9:45am

'Coca Cola Comfortable With 2000, 2001 Growth Expectations' - at TheStreet.com - 8:57am

'Coke Sees Volume Growing 3 Percent' - Reuter Business News - 8:02am

Imagine if you had just read the headline of this article!

That is why it is necessary that one does not go by just headlines. And certainly not the headlines of just one source. There is no substitute to reading the entire analysis and perhaps doing some analysis of your own.

Remember: you are the best guardian of your own interests.

Article 6: Of unintended consequences

(As an investor you need to insure yourself against unintended consequences. What are these?)

The permanent contribution of a thing--movement, event, or meeting--is seldom the intended effect, but an unintended one. What we are emphasising here is that the announced purpose of a thing is seldom its ultimate contribution to history.

As analysts, we are trained to focus on the consequences of every action taken by a company or any action taken by an external agent (such as the government) on the company that we track. Unfortunately, this methodology does not recognize the law of unintended consequences. So, this misunderstood law and oft forgotten postulation causes us much misery ever so often.

Let's start with an example

The law of unintended consequences manifests itself in many ways. Take the power sector for example. Would you believe that one reason for declining water table level in Gujarat is the provision of free electricity to farmers. What? Well, here is the story as heard from a former chairman of the Gujarat electricity board.

The Gujarat SEB, like many others in the country, is in the habit of providing free power to farmers. However, as a result of such generosity (and power theft), the SEB is not in good financial shape.

As a result, its plants run erratically and power supply is erratic to say the least, particularly in rural areas.

Consequently, while the farmers are entitled to free power they are not sure when they would actually receive the power. SO, they choose to leave their pumps on all the time, so that whenever the power does come water would be pumped into the field irrespective of whether they are awake, asleep or not around.

As a result of this, not only do the pumps run for much longer than actually required, but they pump out more water than required by the farmer. This, as the chairman revealed, resulted in a sharp drop in the water table level in several parts of the state.

Not convinced yet?

Fine, you may ask, but what relevance does this have to the world of investing? A lot actually, because an unrelated event or change might have an impact that you do not foresee. Another classic example of this could be Viagra. Did you know that the Viagra is a kind of lucky accident? Well, its application to impotence was discovered in 1992 while conducting research on heart medications?

Pfizer did not go looking for this blockbuster drug, it just happened to notice that the drug had a side effect, which was in effect a cure that many were looking for.

A macro example would convince you better

Let us take another hot topic of discussion-the US economy. Alan Greenspan is cutting

rates vigorously in order to revive the US economy. The economy has been driven by large investments in the tech sector in recent years. But this cutting of rates could have an unintended consequence and to quote from Marc Faber, author of the publisher of the Gloom Boom & Doom Report

> Investment booms driven by technological breakthroughs are deflationary. Railroads cut long-distance transportation costs. The tractor led to huge productivity gains and falling agricultural prices. The Internet has made voice communication almost free. The longer they last and the more capacity they bring, the more these capital spending booms reinforce the deflationary environment. The problem is not insufficient demand but overinvestment, which depresses prices and leads to disappointing profits.
>
> The solution is a painful but necessary and healthy (and, it is to be hoped, brief) liquidation of excessive capital projects. But Greenspan's aggressive rate-cutting will only allow weaker players to complete their projects and so prolong the capital-spending boom. The day of reckoning may be delayed, but it cannot be put off indefinitely. Regardless of central bankers' monetary policies, every capital-spending boom is followed, sooner or later, by massive corporate profit deflation and a very painful deflationary recession.

Whew, In other words the cutting of rates might only delay the inevitable and worse still it might make the eventual consequences even more painful.

Inference that you can draw

Unintended consequences manifest themselves in more ways that we realize. The very fact that they are unintended consequences means that attempting to identify them in advance is a futile effort. After all, how can you predict what is an unintended consequence? Could you have predicted that Viagra would be the outcome of Pfizer's research effort?

As an investor, therefore what this means is that you need to insure yourself against unintended consequences.

This is not an insurance policy in the real sense but rather some steps and thought processes that can help prepare you for dealing with unintended consequences.

- **Spend as much time thinking about what can go wrong**
  The focus of any buying decision is on everything that can go right for the company and for your purchase. But spend an equal amount of time thinking about what can go wrong and pick holes in your own positive arguments. Even though this might not help you identify the unexpected consequences, you might still be able to pick up on the early signs if you have already thought

about it.

- **A stock is a sell until proven otherwise**
  A friend of mine, and a good analyst to boot, once said that the secret of his success was that he treated every stock as a sell until proven otherwise. This is even one step better than spending as much time thinking about what can go wrong.

- **Beware of the consensus**
  This is another rule of thumb that works quite well. More often than not the consensus view is not the right one. And questioning the consensus view can typically help you identify the not so evident risks.

- **Revisit your arguments frequently**
  One way to reduce the downside from unexpected consequences is to revisit your argument for staying invested in the stock on an ongoing basis.

  This is a very difficult rule to implement. One of two errors can always occur-either one could sell the stock for the wrong reasons or alternatively one could stay invested for longer than required before admitting the mistake.

  Phil Fisher, the legendary investor and author of the must read investment classic-Common stocks, Uncommon profits once commented that you need to wait three years after buying a stock to reach a meaningful conclusion on whether you have committed a mistake. The significance of this statement is not that you have to give a stock three years to figure out if you have made a mistake. It is merely that if you are to arrive at a sound decision as to whether you have committed a mistake, you need to watch three years of performance.

  There is no magic formula here, but one simple way to solve this problem is to evaluate your purchases based on the time period you had in mind and the returns you were looking at. For eg, if you expect a stock to double in two years and it has not gone anywhere after one year of your holding it, you need to review your decision. Or if you buy a stock to make just 30% out of it in 6 months and it loses 15% in 2months you must question whether given your risk return framework it makes sense to stay invested.

- **Margin of safety**
  The value investors' focus on margin of safety is perhaps the best possible insurance against the law of unintended consequences.

'What the value investors are looking for is margin of safety. They are looking at buying a stock at as much of a discount to intrinsic value as possible. This provides them with a margin of safety because the future is always difficult to predict!'

The margin of safety provides the value investor with some protection against a negative surprise he did not foresee and gives him a twice the advantage when a positive surprise comes his way.

The better part of the story
With all this talk about unintended consequences you might jump to the conclusion that such consequences are always bad. Not necessarily, remember the Viagra example? J

In fact, the most striking manifestation of the law of unintended consequences is our software industry. The unintended consequence of the Y2K bug was that it gave this industry a boost nobody could have predicted.

If not for the Y2k bug would our software companies have managed to get their foot in the door? Hmmm?

Chapter 4: Market Lore
Investment wisdom in a capsule...

Article 1: The 10 commandments of successful investing

(Coming down the stairs of the BSE building this is what Moses found on the 10th floor landing.)

Moses was coming down the stairs of the Bombay Stock Exchange building after a rough trading session one rainy day and look what he found peeking out of the false ceiling on the 10th floor landing, written in the hand of God...

God entrusted to Moses the noble task of protecting the small investor from the vagaries of the market and the attempts of various vested interests to waylay them on their path to safe investing. Safe investing, said God, was a mere matter of following these ten simple rules.

Commandment 1: Don't attempt timing the market
Market timing is no guessing matter. To the little investor, timing the market is like taking a random walk. Most people only recognise the correct path after already having set foot on the wrong one. One exception to this is 'bottom-fishing', an approach to buying stocks that you want in your portfolio at prices below prevailing levels. This entails biding your time and buying into a market downturn before others do (the age-old philosophy of buy low, sell high), the downside of this approach being that the stock you want may never see the downside you expect.

Commandment 2: Don't try to outguess the market
Market psychology is for shrinks, not for couch potatoes like you humans are. What captures the imagination of the market is transient, which means that what is `in' today is `out' tomorrow. Most people only recognise the pattern after it has become apparent to almost everyone else and is too late to act upon. For example, if investment in technology appears to be the current flavour, you are probably already too late to cash in on the trend. In this instance, you should only invest in technology as part of a long-term balanced approach.

Commandment 3: Treat investing like marriage - go for the long haul
Short term investing could go either way. Invest long term. Almost all market pundits

and investment studies show that stock investing should be part of a long-term strategy, lasting 5-10, even 20 years, or longer. Beware that not every year will result in a positive return on your investment. However, over time, the plus will likely overwhelm the minus by a substantial margin.

Commandment 4: Stay clear of broker's advice, hot tips and "multibaggers"
Every portfolio advisor is not a Sharekhan (J) who swears by sound investment principles. Think. Wouldn't most brokers be tempted to make their living by goading their clients to constantly move in and out of positions, thus garnering commissions? This is diametrically opposed to Commandments 1, 2 and 3. For most people, stock advice is like a game - of darts! Only accept advice if the person has your financial interest in mind - truly, that is - and is not making a living by selling your stock. And of course never buy from someone who calls you J.

Commandment 5: Almost always invest in blue chips and blue chips-to-be
Do invest in companies considered to be `blue chips'. These not only include the BSE 100, but others that are slowly stepping into the big league as well. Only invest in established companies with good track records. Beware that not every blue chip will increase after you buy it, and that even these otherwise stellar performers will have their good months/years and bad months/years. But, over time, the fluctuations will even out and you should be left with a considerable net plus. Also invest in companies which have a good record of declaring dividends (and if you find the solitary one that increases dividends each year...you know what to do).

Commandment 6: Prefer steady instalment-like buying of stock to buying in one go
Investing should never be done in a panic or treated as an emergency. Purchasing your favourite few is best accomplished at a steady rate over a period of time, so as to avoid the ups and downs of the market. This is called rupee cost averaging and is one of the safest approaches to investing. It works just like any other habit - you buy, regardless whether the price is up or down, until you reach the desired number of shares of that stock.

Commandment 7: Diversify, diversify and diversify
Do diversify your portfolio, both within your selected sectors and within overall industry. For example, don't invest only in technology because it happens to be in vogue today, but consider other industries as well.

Commandment 8: No shopping with borrowed money and maintain a core reserve
Never use margin money to buy stocks. You should not invest money you don't have. A simple and basic rule is to not leverage yourself to an extent that when the tide turns against you, all you are left with is nothing.

You never know when a financial emergency might arise. That's why you must keep a comfortable cash reserve in your savings account, so you do not have to tap into your long-term investments. A reserve equal to 6 months of salary should be just about ideal.

Commandment 9: Set realistic financial goals
Treat a 500% return with as much derision as you would a 5% return. Decide what you need the money for - to retire early, to finance your kid's college education or your daughter's marriage? Or just in order to preserve and build wealth? Whatever the goal you set, make sure it is reasonable and attainable. Expecting too much will only lead to disappointment down the road. Aim for an expected return level that is realistic - not mediocre or overambitious.

Commandment 10: There are 10 more commandments!
For those who thought that was the last of that, I have good news. There's more where that came from! Ensure that your portfolio size is controllable (15 stocks is about ideal), and your stocks are well researched. Checkpoints: Is the management quality above board? Does the company have a positive cash flow? Does it have the capability to compete on a global scale? Most importantly, is it shareholder friendly?

Finally, leave your emotions behind when you enter the world of investing. Follow the ten commandments. Time is on your side. Investment success won't happen overnight, so stay focused on long-term returns and avoid overreacting to short-term market swings. Remember, investment success depends on time, not timing>.

Article 2: The 5 Steps to Investdom

(They say the stock market makes fool of everyone. Well, we have different ideas...)

To share or not to share
"The main purpose of the stock market is to make fools of as many men as possible" - Bernard Baruch

Oh? And we thought people flocked to the stock market because they believe they are wiser than the next guy and would naturally bag the bigger, better deal. Fear not, for we believe Mr Bernard was not really referring to the well aware investor in the market who abides by its investing credo. We say the main purpose of the stock market is to help enrich those who consistently save and invest, who have a 'buy and hold' philosophy. Our paramount advice to the retail investor: *Dispel forever and ever the notion that you can correctly predict the daily swings of the market*.

Why invest?
Which brings us to the next question - in that case, why invest? To fulfil certain needs or desires. You may have certain personal goals, ranging from, say, an early retirement, marriage, and kids' education to more specific material stuff such as a swankier car, a bungalow, and what have you... You may invest in order to make above normal returns, or maybe just to keep up with inflation, which presents itself at every turn like an unwanted ingrown toenail.

Raring to go, but proceed with caution
You're probably itching to take the plunge and start investing right now. But hold on - we don't generally eat dessert before dinner do we? So how can we invest before learning how to?

Investing can be relatively painless, and the rewards plentiful. Investing successfully in the stock market could buy you your retirement, overseas education, dream holiday or simply enhance your status in the family to Most Cherished Relative. The following five rules and a prayer on your lips should take you there.

Steps to Take Before Investing

1. Invest your own money -- credit cards are strict no-no

The stock market and the world of investing are all about making more money than you would elsewhere. But before you get initiated into this system, make sure you aren't hitching a heavy debt-laden cart on the investing pony. Huge credit card bills, loan instalments, can be bad news when it comes to stock investing. And finally, don't invest on borrowed money. Playing the market on debt is something we won't be advising you to do.

2. Provide first for the necessities -- avoid putting that antique grandfather clock on sale

God forbid, but in the rare occasion that you find yourself out of a job, you must comfortably land in the safety net of an ample corpus to protect you and the family from unexpected situations. You never know what tomorrow will bring. Unemployment, medical ailments, accidents, a housing need and other such contingencies should be accounted for.

Set aside a liquid reserve fund that covers six months of living expenses and contingencies, failing which you run the risk of finding yourself at various auction sites on the web, trying to find buyers for that beloved antique grandfather clock.

3. Plan for the future -- an outstanding housing loan instalment is a taboo

Understand your current spending pattern. The idea is to know exactly how much you can afford to invest in stocks. If you have a big housing loan to repay in the next three months, you cannot afford to stay fully invested in stocks with one-year horizon without planning for this payment. Else on the day of reckoning you will have to sell your stocks cheap!

4. Identify your objectives -- can't buy oranges if you want to eat apples

There is a general perception that apples and oranges taste different, look different and offer different nutrient values. The same holds true for different stocks. The most important groundwork in developing a portfolio is establishing and identifying your objectives. While everyone's needs and goals are different, it is important to sit down and know what you currently have, what you will need for day to day living expenses, and what future long-term strategic goals you want to achieve.

5. Invest time in market - save short-term funds for the family Caribbean cruise

Invest money in the stock market that you won't need for at least three years, and preferably five years or longer. If you'll need your cash next year for a down payment on a house or for the family Caribbean cruise, use one of the shorter term and safer havens for your cash, such as money market funds or bank deposits.

Sharekhan believes that these five points form the prologue to the investing novel. Let the above rules take centrestage in your head before taking that leap. If you can conjure up some more ground rules, post in your comments. We welcome an education too!

Article 3: Five soul-searchers before selling a stock

(What's easier - buying a new shirt or disposing of your old one?)

What's easier - buying a new shirt or disposing of your old one?
What does a rising market do to you? You probably get complacent about your investments, just as you panic when the market takes a dive. Recently, when the BSE Sensex slipped some 900 points over 10 trading sessions, the natural reaction of a lot of investors was to get out. And get out... faaaaastt! But just as buying a stock is the end result, or should be, of an extended period of research, selling is also best done only after cool deliberation, not in the heat of crumbling markets. Do we hear murmurs of 'easier said than done'?

After all, buying 'Annapurna' atta, a 'Gillette' shaving system, a pack of 'Nescafe' or the latest 'Color Plus' shirt we do every day, whereas most of us have much less experience selling these products. Believe us, even we - after years of prowling Dalal Street in a dark cloak - find it much easier to buy rather than sell stock.

Because, while selling, we are beset by a host of questions. Do we sell winners in order to lock in our gains? Do we dump losers because they are, well, losers? Do we set price targets for each stock? Or do we follow Warren Buffet's investment style and treat stocks like marriages, never to be broken or betrayed?

Making sense of stock price movements
We carried out an off-the-cuff survey on what could be construed as dependable sell signs. Are there any in the first place? We came up with some very interesting feedback. One of the most obvious sell signals that's not dependable is a company's stock price - despite the attention we may lavish on its every move. Consider Hindustan Lever, which has fallen by nearly 35% over the past one year. You're thinking it's time to sell, right? Wrong.

What good does it do to sell after the stock has fallen? Whatever the bad news, it's already incorporated in the stock price by now. The more rational reaction to a dropping stock price should be the exact opposite of selling. If we really like the company, we should take advantage of the lower price to buy more.

In the case of Hindustan Lever, the stock has fallen because of a couple of quarters of top line underperformance, which we believe to be temporary. If we bought HLL because we liked the firm's long-term prospects and because the stock's valuation was attractive, a declining stock price over the short term should be little cause for concern.

Likewise, just because a stock has risen is no reason to sell. It's always so easy to sell (or fail to buy) a great stock simply because it's already had a good run. Remember Infosys or Pfizer? You always thought you would buy those stocks on their way down, right? But an abundance

of examples show that these stocks may never find 'their way down'. The fact is most of us would be better off if we could block out all those graphs of past stock performance. They convey no information we can profitably use now.

So what are the points to ponder before selling your stock?
Having established that past stock price performance is no reliable indicator for buying or selling a stock, here are what we agreed on to be a more dependable set of sell signals...better represented as questions an investor could ask himself.

1. **Have the company's fundamentals changed?**
   It's often tough to distinguish the normal fluctuations of a business from long-term shifts in fundamentals. If Infosys, because of a change in the foreign exchange rate (the rupee becoming stronger against the dollar), earns a little less than analysts' expectations, we wouldn't really care, since the company's long-term prospects remain unhurt.

   But if the changes are deep enough, the reasons why we bought the stock may no longer hold. We might own a Silverline Technologies because it was growing rapidly and valuations were attractive. But if then some news comes along on the company's accounting irregularities, we'd much rather be donning our warnings cap.

2. **Have I made a mistake?**
   Ever bought a pair of shoes that do not fit or a music cassette that was unspooled? These bad purchases could happen with stocks too. Just like one would reverse the above faulty decisions, you could do the same with your bad investment. Closely related to changing fundamentals are misunderstood fundamentals.

   Take the case of Real Value Appliances. At first glance, the vacuumiser that it introduced in the market appeared to fill the gap that a housewife had long waited for. With an attractive product and a virgin market to exploit, many were touting this company as a tempting buy.

   After a little research, however, it turned out that Real Value had problems maintaining product quality and hitting on the correct price chords. Result: the company lost money since the year of the launch of the vacuumiser. The stock has lost 90% of its market valuations since then. A real pity. The lesson here is: rather than hang on to a mistake in the hope that it stays above water, it makes sense to switch the money to a more compelling stock.

3. **Can I sell if I have a 'better investment option'?**
   When a business grows rapidly, the stock price will naturally trace the same pattern. But when valuations rise, the stock normally tends to outpace the business. Effectively, the price in the numerator of the P/E ratio will rise faster than the denominator, that is earnings. If we buy a stock not because we love the company, but because it is cheap, a rise in valuations means it's probably time to move on. Simple, isn't it?

4. **Is it time to change the menu on my stock portfolio to make it more balanced?**
   You love having idlis, but can you have them everyday? Prudence counsels spreading risks around, and that includes rebalancing a lopsided portfolio. Should we enter a recession, cyclical stocks are likely to do poorly. And should the bull market come to an end, portfolios concentrated in high-flying, expensive stocks (read technology) could be in trouble.

For safety's sake, it pays to periodically check to see if a portfolio is diversified, with a good mix of sectors and maybe clusters too (take a peek at ShareKhan clusters)

5. **Should I sell less attractive stocks to buy into the current fall in my favourite?**
What would you see if Infosys' price suddenly dropped down to Rs3,000 or Hindustan Lever's to Rs125? A great opportunity to buy some more of the same, of course! In such scenarios, where your dream stocks are going at basement sale prices, it may just make more sense to dump some of the less compelling parts of your portfolio to add more of the cheaper favourite stocks. After all, money is a scarce commodity.

Money happy returns if you stick to a sell discipline...
What's most important is not so much these five soul-searchers themselves as the thinking behind them: that selling stock by a set of pre-established rules surely beats offloading on a gut feeling or because of the current dull performance of a stock in a bad market. A sell discipline forces us to have a good reason for getting out of a stock - a reason based on important considerations such as company fundamentals and portfolio composition, not on "noise" such as fluctuations in prices.

It is logical then that a sell discipline tends to reduce selling. When markets go through one of their periodic hiccups, it's the people with a sell discipline who refuse to panic, who don't sell after stocks have already tanked, which of course is the worst possible time to dump a stock.

Plus, there are the nasty tax consequences of selling frequently. By making sure every sell decision is justified, we'll inevitably cut down on paying capital gains taxes. Knowing when not to sell may actually be the one of the best ways to improve long-term investment returns. And one which could lead to the fulfilment of your long-term dream of moving out from the ancient building to the latest high-rise at Napean Sea Road!

Adios, amigos.

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