Are you fit to invest in stocks?

To succeed, an investor must have the right temperament and reasonable expectations from the market.

The advent of 24/7 commentary on TV channels and the popularity of social media forums have spawned a breed of people who think that the real test of an investor (or a fund manager) is his ability to predict exactly how the stock market, or each individual stock price, will move.

Each correct prediction increases in geometric progression the expectation from the next prediction. In reality, it is impossible for anybody to correctly predict all the time, simply because the number of variables that determine the short-term price movement of stocks runs literally into the hundreds. Investors should not even try to do this. Instead, they should focus on what really matters.

If we agree that the purpose of the capital market is to reward the efficient use of capital and punish those who fail to do so, we must also agree that the real tasks before an investor is to identify companies that efficiently use their capital, and use his own capital efficiently. The first would require intelligence and the second the right temperament, which is essentially self-generated. We can call these external and internal factors in investing.

As in any other endeavour, stock market investing needs basic intelligence. The 'intellect' part of investing, which deals with the external elements such as economic trends, industry and company fundamentals, FII inflows, etc. are certainly important. But the investor (or a fund manager) also needs the right temperament, which is essentially made up of internal factors. He must be able to:

- Frankly admit what he knows and what he doesn't.
- Demarcate the risks he is willing to take, and ones to avoid.
- Accept that shares of good companies can remain depressed for a long time, or that shares of mediocre companies can shoot up.
- Remain committed (despite acknowledging the previous point) to buy only the kind of shares that he wants to buy.
- Acknowledge that the means are as important as the ends.

While most investors attach high importance to the 'intellect' part of investing, sadly the vital aspect of temperament gets less attention. This leads to an unfortunate consequence: we expect the world to function the way we want, and become frustrated when it does not.

Many investors are disappointed that the economy did not 'take off' as expected after the incumbent government was sworn in with a big majority in May 2014. But if we expect a $2 trillion economy to start soaring within a few months (after a three-year slump) simply because one party won the elections handsomely, we have nobody to blame but ourselves. Having a reasonable expectation from the stock market is therefore the essential first ingredient.

E.A. Sundaram

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equity funds remain invested beyond two years. As our study shows, this short-term outlook of small investors can come in the way of their long-term wealth creation plans.

The other problem in the invest-more-on-fall strategy is the availability of funds. "SIPs can be advanced subject to the availability of cash flows," points out Khandelwal. The SIP is a convenient tool aligned to the cash flows of a salaried investor. The average salaried investor may not have an investible surplus lying in the bank, which can be quickly deployed when markets have crashed. This is why some financial planners advise clients to maintain a tactical buffer for such investing opportunities coming their way. "Investors need to set aside some tactical cash in liquid funds and use such opportune moments to add more to the funds in which their SIPs are running," advises Srikanth Meenakshi, Co-founder and COO, *FundsIndia.com*.

"The market is volatile but tends to outperform over the longer term. Constant tweaking of the investment does not always deliver the best outcome."

A. Balasubramanian
CEO, BIRLA SUN LIFE MUTUAL FUND

"After a short-term dip, the market is up even before investors realise it. Stopping SIPs or trying to enter later does not work in such instances."

Srikanth Meenakshi
CO-FOUNDER AND COO, FUNDSINDIA.COM

"Market timing is a game most investors will lose. Leave alone an average investor, even the so called experts cannot predict the market movement accurately."

Vipin Khandelwal
FOUNDER, UNOVEST

The SIP advantage

It is often said that the biggest advantage of an SIP is that it takes emotions out of investing. The investment decision is neither governed by greed, nor triggered by fear. Your money gets invested in the market on a predetermined day, irrespective whether the markets have gone up, fallen down or remained sideways that day. The investor is not left waiting for an opportune moment to invest. "In a falling market, there is tendency to wait for a further fall. At the same time, in a rising market, there is a tendency to wait for a correction. In both events, investors who wait tend to miss out," says Balasubramanian. For those who are worried about the market levels, the staggered entry through SIPs spreads the risk across time and allows rupee cost averaging.

Even though SIPs mitigate the risk, investors need to monitor the performance of their funds. If a fund has consistently underperformed its category and benchmark for 2-3 quarters, it may be time to junk it and move to a better fund. "You need to be clear on whether the fund is underperforming or if it is market underperformance. If the performance has slowed, stop SIPs in that fund but also make sure you start fresh SIPs in another fund," says Meenakshi.

Rebalancing the portfolio

The other reason to stop SIPs is that your goal is approaching. Investors must realise that whether they invest through SIPs or lump sum, the portfolio carries the same risk. One needs to reduce this risk as the investment goal comes nearer. If your retirement is just two to three years away, stop SIPs in the equity fund and start a systematic transfer plan into a debt fund. "Reallocate the corpus between debt and equity funds after a certain age. As one approaches retirement, the need for interest income may warrant an allocation from equity to debt," says Balasubramanian. Likewise, if you had started SIPs for your child's education, start switching to debt about one or two years before the admission date.

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