Sensex 12000…12800…13000... What to do?

It is time for review when we see an all time high in the market. There is fear that the market will collapse, is this rally genuine? There is lurking desire that the best is yet to come. Then there are those who never invested in the market, seeing the prosperity of the market they would wish to be part of the action. The question that is posed by most investors is what do?

Let us first understand what the rise in index signifies. Index as a statistical formula is the weighted average of the market capitalization of selected stocks. Stocks are selected on basis of certain criteria such as liquidity i.e. number of shares traded per day, number of shareholders, company performance i.e. profits and divided payment, corporate governance, size of capital etc. Care is taken to ensure that majority of the industries are represented in the index. Market capitalization (cap) is nothing but the total shares the company has issued multiplied by the current price of the share. For eg if a company has issued 100,000 shares and the current price per share is Rs.1,000 then the market cap is 100,000 x 1,000 i.e. 10,00,00,000 ie Rs.10 crores.

Taking a simple average of the share prices is not enough, since the market cap varies of each company (depending of size of capital) it is necessary to assign weights, i.e. company with higher issued capital will get a higher weight Hence weighted average price of all shares is taken for the purpose of calculation. Obviously, increase in price of Reliance will impact the index more than say a smaller company such as Cipla. Another important concept is free float index. Since not all shares are available for trading, to the extent that the shares are in lock-in or held by promoters, the share capital is reduced by such number of shares. This thus makes the index totally liquid. It should not so happen that the index keeps going up or down without trading or liquidity.

Index is always computed with reference to a base year. The change in share prices is as compared to share prices prevailing at a particular point of time. In case of Sensex the base year is 1978 and in case of Nifty it is 1995. The base index was 100 for Sensex and 1000 for Nifty. Adjustment is made in the share price for corporate actions such as splits, bonus dividends etc. Companies such as Tisco, ACC and Grasim have been part of index since inception. Prices of these shares have grown by about 128 times since inception during last 28 years,since the Sensex has grown from 100 to 12800. The Sensex which is the most popular index is owned by BSE Ltd and has 30 stocks in it, whereas the most frequently traded index, Nifty 50 tracked on National Stock Exchange has 50 stocks. There are many more indices such as BSE 100, BSE 500, Tech Index, Mid cap index etc. Newspapers also have identified certain stocks and they are also have devised certain indices and are regularly computed. Index is computed every few seconds when the share prices keep changing. The companies that form part of index are also reviewed periodically and advance notice is given when a company is removed or added to the list. Sectoral indices indicate how a particular sector performs on the market.

Some people ask as to what happens to all the wealth that is created when it goes up and vice versa! Well, both the creation and destruction of so called wealth with market movements is only notional till someone actually encashes it, and no body can buy or sell the whole market at one shot. Your wealth will increase proportionately only if you own shares that are part of the index in same proportion. Further even if you own other share it may not go up in same proportion as index. A 10% appreciation in index does not translate to 10% increase in each and every stock. The increase will be determined by weightage. Some shares willappreciate more than the others.

Index is said to be an indicator of the economic health of the country. Unfortunately since very few industries are represented on the exchange this statement is not true. Important sectors that contribute to the GDP of the country are not listed. Transport sector companies such as Indian Railways, Air India, Indian Airlines, National Highway authority ports etc are not traded on the exchanges. Insurance companies such as LIC, GIC and its subsidiaries are not listed. Mineral sector is not represented. Banks continue to have a large shareholding by Reserve Bank and Government of India. The list goes on. Hence Index can at best represent the collective sentiment of Indian investors towards the economy.

A review should happen when the market reaches all time high. The sentiment is most positive at such times, hence you may get a good price for your share if the growth story associated with your share has been achieved and you have reached your targets. It is not advisable to sell off just because the index is all time high, your share may still be under valued. At the same time despite a sustained increase if your company share has failed to appreciate, then a hard look at company performance is warranted. If the share cannot perform in a very positive environment then it is difficult to do so in normal times.

For newcomers it is a good strategy to stick to index stocks since there is a reasonable certainty about the liquidity, quality of management and financial performance of the company. However entry into such shares should always be in correction phase. An all time high index is not an entry point. A correction is a good time to enter. There is nothing like missed opportunity. The zigzag graph that we see of index signifies that there are constant corrections in the market and straight lines are few and far between.

If you are unclear which stocks to buy then index is a good bet. You can buy index in derivatives market. Index futures as well as options are available. Nifty Futures is a highly liquid instrument that is available on National Stock Exchange. If you expect the market to go up then you can buy nifty in futures or a call option on nifty. If you expect the market to go down then a nifty can be sold in future or you can buy a put option. But to revert to the first point of review when the market is all time high, what do I do? Well it is an occasion to celebrate, but any action taken of buy or sell should be based on review of company valuations and future prospects. HAPPY INVESTING!!

Asit C. Mehta
INVESTMENT INTERRMEDIATES LTD.
E-mail : acmiil@acm.co.in
Group Website : www.nucleusindia.com
Online Trading Portal : www.asitmehta.com
SEBI / Regulatory Registration Numbers :
BSE C.M. : INB 010607233
NSE C.M. : INB 230607239
DP Registration (C.M & Derivatives) : IN - DP - CDSL - 28 - 29

Edited by Deena Mehta, Managing Director,
Asit C. Mehta Investment Interrmediates Ltd. E-mail: damehta@acm.co.in

Registered Office :
Nucleus House, 5th floor, Saki Vihar Road, Andheri (E),
Mumbai - 400072. India Tel.: 022-2857 7898 or 2857 7614/15/16
Fax: 022-2857 7647
Corporate Office :
67, Poddar Chambers, 3rd Floor,109, S. A. Brelvi Road,
Fort, Mumbai - 400 001. India Tel.: 022-2270 0115, 2265 1540
Fax: 022-2270 0124