

Investment strategies – for the meek, mild and aggressive...

How open are we to taking risks? A simple experiment would suffice to yield revealing answers. If we were to ask same-sex twins the same question -- "If you had to decide between a sure win of Rs 30, a 20 per cent chance of winning Rs 500 or a 50 per cent chance of winning Rs 100, what would you choose?" – their answers could be very different. Any two people's approach to risk-taking is different even if they happened to be siblings. The appetite for risk differs significantly from person to person and from time to time. One has access to much more information today – many websites help assess one's risk profile – and therefore we do tend to change our minds too more often.

Your risk appetite determines the type of companies you select for investment. Your investment strategy is largely dictated by your attitude to risk. Are you a conservative, a moderate or an aggressive investor? We propose to discuss various strategies for stock selection based on your perception of risk.

There are those who are extremely risk-averse and would like to go for near fixed returns investments. These investors constantly look for strategies where the downside of risk is minimal: they would opt for high-dividend paying companies or companies with large payout ratios. They would go in for companies with a good record of profitability so that there is regular payment of income, as with fixed- income

bonds. Safety-conscious people also prefer companies whose book value is greater than the share price. They view these shares as cheap since they get more value than the price they paid. Stocks with low price earnings are also seen as a steal since there is lot of room to grow.



The moderates look for good companies that have a track record of growth in terms of sales, assets and profitability. These companies are well managed and follow good governance practices. They look for growth within all financial parameters, and not necessarily dividends alone. They look at rewards from the share market in terms of price appreciation rather than payments from the company. This group also tracks the shares of good companies, and if a sudden drop in the market brings down the price of their favourite share disproportionately, then the share becomes a good buy. They will purchase more at low prices to reduce their average holding cost if they already have stocks in their portfolio. Small and mid cap stories are also of interest to this group since they are looking for Reliance in the making.

The aggressive are those who want to be on the fast track. They are with the momentum stocks. They spend a lot of time ascertaining the highs and low of the dominant market players and try and ride the wave emerging out of sentiment-driven activities. They are looking for low-priced stocks where nominal investments would give large returns. This group of investors is on the look-out for early news on developments and material information on companies; in their case, even rumours could influence the share price.

Somewhere between these three groups are those who believe in a more passive investment strategy, who regard equity investments a must in their portfolio. They buy what they believe to be good company shares and then do not do very much with them.

Each strategy has its pros and cons. A company may appeal to one investor in some aspects, but not to another investor. A high-dividend paying company, a plus point in a conservative buyer's eyes, would not find favour with someone who believes that the company should be reinvesting and growing rather than giving away cash to shareholders. He would look at the share market to give him returns on his investment in the form of appreciation in share price. Similarly, momentum stocks would appear too risky to the conservative investor.

Irrespective of your attitude to risk, there are certain simple rules that should be observed when selecting stocks. After all, if we take pains over relatively simple purchases, such as a television set or washing machine, then the companies in which we want to invest too deserve careful scanning. You could list them

according to "fastest growing", "highest dividend-paying" or momentum stocks. Many websites provide such information for virtually no cost. Once this list is prepared, apply the general rules for stock selection. Look for good fundamentals, such as growth in sales, assets and profits. Corporate governance and good management are a must. A three- to five-year history of survival provides reasonable confidence in its staying power, unless you are a venture capitalist. Thorough research on the target company goes a long way for even if your basic assumptions are belied and you have to hang on to your holding for a long time, your investment does not become worthless.

In the short run, it is the collective psychology of the

market participants that drives the prices of shares. Very often, good results bring down the share price since the market too was expecting this, and discounts it when it does occur. A new story would impact the price to go up or down. When unfavourable news is expected, that leads to a price rise since the worst is over and better things can now happen to the company. Unbelievable as it may sound, each investor's perception drives the market collectively.

Often, the man on the street finds the market very confusing. My suggestion is to follow your instincts. Basic common sense is the best approach to investments. Do not buy a share that does not appeal to your intellect and good sense. Nobody, obviously, puts all their money into one company. Relying on rumours can harm a carefully nurtured nest egg. Naturally, we do not put the school fees or the money from which the next meal will come in any market. Let's try and keep investing a happy, safe and profitable exercise.

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