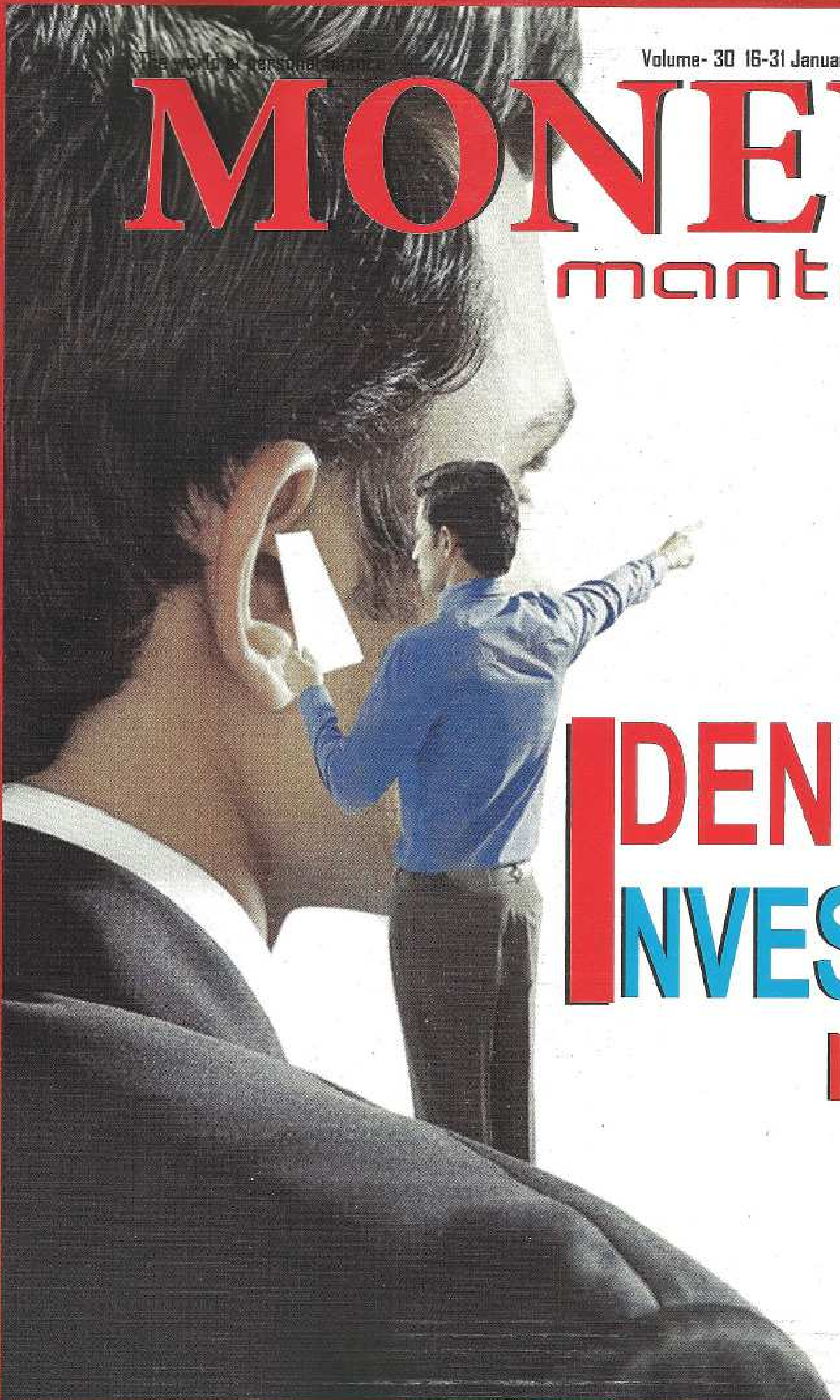
NIFTY 6011/5763 SENSEX 20073/19224 DOW 11573/ 11637 FTSE 6008/5956 NIKKEI 10279/ 10541 CRUDE 9474/9548

The world of personal finance

Volume- 30 16-31 January 2011 Rs 30

MONEY mantra



IDENTIFY INVESTOR IN YOU

Stock Market Data 18 Pages MF Return Gallery

GOLD 20360/20300 SILVER 44553/45024 US DOLLAR 45.11/45.44 POUND 69.61/70.54 EURO 59.16/58.68
Rates indicate fluctuation between 26th Dec to 10th Jan 2010

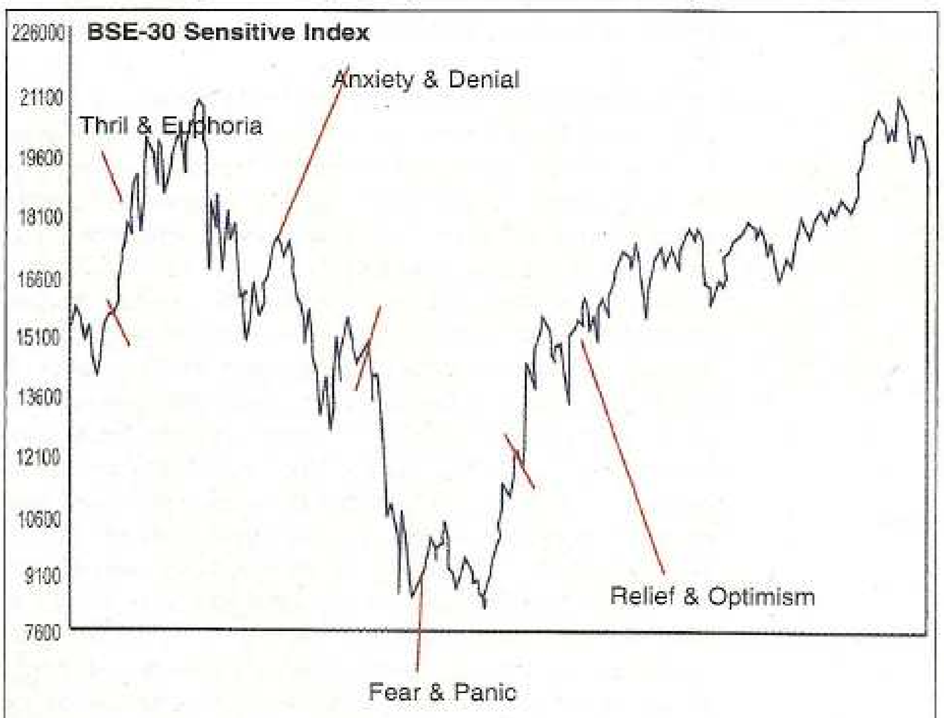
Hemant Beniwal/ Madhupam Krishna

Once I gifted a box of sweets to my friend. What I could read from his facial expression was that the sweet box didn't excite him much. Generally, we expect a person to become happy when we gift them something. The look on his face made me conscious. Later, I came to know that my friend was a diabetic and avoided sweets. The sweet box was enough to tell the tale of my friends' mind. Take another example. When the market starts falling a person having short position starts rejoicing. But think of those having long positions. They get butchered and their faces turn gloomy. Here situation (falling market condition) remains the same, but two different individuals react in different manner due to their positional stake in the market. Now let us reverse this and ask you a question. One of my friends got depressed when sensex gained 500 points in a day. What short of positional stake he would be having in the market? You are right! He must be carrying some short positions. What I mean to say is that reaction to a specific situation tells a lot about our state of mind and our investment behaviour. It speaks of investment attitude as well.

We all are born with some instincts. Some of them can be changed and some can't. Investment attitude is reflection of our basic instincts. A mentally relaxed person generally opts for long term investment, waits patiently for investment opportunities, and doesn't take investment decisions in a hurry. Contrary to this, an overconfident person takes investment decisions in a fraction of a second, assuming that he is the only person privy to secret details about that investment avenue, changes his own decisions a moment later, incurs loss and feels confident to recover the loss the very next moment. It would be better if we could know our own investment attitude, behaviour and style. There is nothing wrong in diagnosing ourselves. Knowing the category we fall into, we may devise a strategy to have maximum benefit of it. If that category is not conducive for taking investment decisions, we'll try to modify it. If we are not able to modify it, better is to outsource investment planning to some expert. This write up is an attempt to peep into the psyche of an investor and understand the core factor influencing his investment decisions. Read on.

Decisions make a lot of difference in our lives. While right decisions at right time can chart a good future, wrong ones can screw things up. This holds true for our finances also. Those who intelligently plan their finances always have an edge over those who invest money in a haphazard manner and without any proper planning. But we also can't ignore the fact that everybody learns from mistakes. It is human to err, but learning from it and not repeating the mistake is what is expected of a mature investor. Maturity comes over time. To grow up as an investor, it is important to do a self-check to understand the weaknesses and shortcomings which could help rectify them. But foremost is to understand that what kind of investors are we. This can be judged from how we react in different situations. Let us discuss four time periods or situations -

Let's also attempt to know how behavior was responsible in the last three years. The data in study is the BSE Sensex movement from September 2007 to September 2010. These three years were a good ride for sentiments but the bigger question is -- has investor, particularly the equity investor, has learned something or not? If we would have taken this graph from 2000, this would have been almost the same in many ways. People say market moves in cycles - yes, but it is a cycle full of emotions. This cycle combined with response that you get on your emotions decide the losers and winners. To simplify things, we have sorted out the four main emotions or situations. We have shown that how different type of investors react in different situations - you can check is it you?



How different investors react?

We start with best time of market. But were that really the best time? It depends on what type of investor you are.

It is amply clear that reactions vary from person to person. It is the behavior which influences our reactions. Our entire childhood has gone hearing this phrase from our parents and elders-"Behave yourself..." Thanks to this stock phrase, most of the mannerisms, etiquettes and emotions that we display in public, are shaped by our desire to "prim and proper". Basically, it is the behavior which controls our cognitive responses and emotions and overall personality. But imagine a day, your mutual fund advisor or your stock broker calls and tells you to behave. We know that would be his final call, as you will end your business with him. But seriously, the financial behavior of most of us has not been shaped properly. Let me elaborate with some live cases that we have faced in our career to show how your behavior is important in managing your personal finance:

Mr Mudgal sold all his stocks, including the blue chip stocks, that he bought a week ago, on hearing the news of artillery firing between the two Korean countries.

Mr Ravi, a heart patient, invested into a sector-specific fund even though his agent advised for an SIP in that fund.

Mr Gautam did not sell his stock 3 months before his daughter's marriage when the markets topped. His answer was "not to take a decision to sell, is also a decision".

Mr Paswan shifted all his mutual fund investments to liquid and stopped SIPs in March 2009.

Let's check if whole market participants think in the same direction. See the graphic below. With the Sensex movement investor entered at wrong time. But why do we blame market participants. It was us the investors who had signed forms and handed over cheques to the market participants.

And are mutual funds or passive investments, safe? When the nifty PE increased, the sales increase simply shows that investor got carried away in the euphoria and as a result lost money.

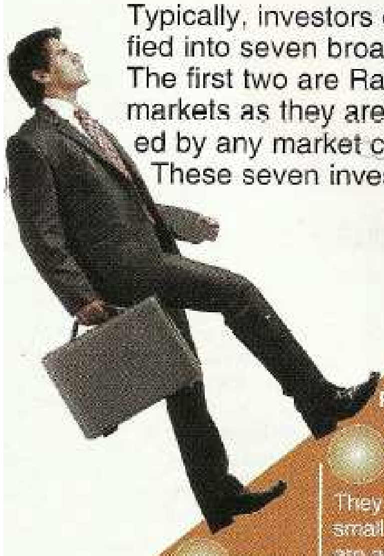
We all agree that peace of mind is the most important thing when it comes to financial decisions. But the common behavioral blunders, makes for some sleepless nights. The symptoms to identify the financial behaviour errors are:

Overconfidence: If you ask, who manages better finances, man or woman? Lot of men will reply in favour of the former. That is overconfidence. Same type of arguments goes when it comes to predicting markets or economy. People in their middle age are affected by this symptom to a large extent. "I did this" or "I started with Rs 1,000 in stocks" are the statements you get, when you speak to them. They would have no correct predictions but will have an "I knew it" kind of sumgness to all things which go wrong in the investment space.

I follow-you follow: ...my boss is very good when it comes to manag-

TYPES OF INVESTOR

Typically, investors can be qualified into seven broad categories. The first two are Rajnikanths of markets as they are not impacted by any market conditions. These seven investors are:



Only Savers: Majority investors in India are from this category. When you say equity, they will look at you as if you were some Andaman tribal people lecturing on GPRS. They never invested a single penny in equities. Their answer to equity is - equity is risky so why take the risk. They are happy with what they are getting but not greatly thrilled, all the same.

Regular Investor: This is a rare breed. They have a long term view over equity. They will never discuss small market events. They are also a bit mechanical in investing. They invest when they have a surplus and withdraw when in need. They are convinced over the fact that equity will beat all other investments in the long run. Generally, you feel very comfortable in their company as they understand finances and talk sensibly.

Now come the investors who are actually affected by market see-saw or roller costar rides. From here, we dedicate this story to them.

Window shoppers: They will be the first to read or get information about an investment but they will never participate in markets. They will constantly float opinions and talk about personal finance but will not dare to risk own money. He is the non-playing captain who will never dare to sweat himself but would be the first one to talk about strategies.

Seasonal Traders: These are experienced people but who have earned nothing from the investments. These are generally close to employees of trading house or investing professionals. They live in a fantasy that all the "first news" comes to them. They show they are waiting for the right opportunity to make a killing in the markets. They are irregular investors and have high volumes of trade but what about earnings??... Keep guessing.

Scapegoats: He is basically a friend of financial product sellers. Agents complete majority of their targets form these investors. He takes advice from all... from colleagues, panwala, fellow bus travelers etc. Absolutely, no discrimination at all. He is typical 9 to 5 person busy earning money and managing his daily chores, thinking he would be rich someday. Brokers enjoy their money.

The Hi-tech Lalaji: These people are champs of their business and think that they can be successful when it comes to investing too. They suffer from "I know everything" syndrome and do not hesitate to show off there contacts. Their common reactions are - Don't give me advice.... I have been investing before you were born.... I traded in gold when it was Rs 600 per tola.... Pay for advice? Instead make me your partner ...Thinking of meeting Jhunjhunwala ji to discuss a new idea.... They display an experience, you wish you had yourself!

Mr Cool: These investors never panic and hold the nerves at all times. Th are cool and confident They work against her mentality and are read to listen to others' view points. They take decisions on their own and stick to it. They follow ciplined approach and rarely invest in dubious schemes. They advoc transparency and app ciate the longevity in investments.

The last five investor types are affected by market conditions and they rebalance as per their mentioned charac teristics.

Recently, we interview five such investors. Yo can check what they replied to similar questions.

Which Category you Fall Into

	How much money you made in the last 3 years?	Do you believe you will easily achieve your retirement goal?	What's your biggest investment mistake?	What's your Biggest investment success?	What's your investment strategy?
Window Shopper	Substantially higher than others	Yes, it is very important aspect. I have made provisions for it. I always do it first.	Nothing as such	I could predict the low and invested all my money during that time.	With the virtue of my experience, research and knowledge, I predict the time of entering and exiting the markets.
Seasonal Traders	5-6% every month on my funds	Forget retirement plan. Let's try to earn every thing now.	I entered late in gold	People say equity is for long term but in 2007, I made 20% gains on RNRL lot in a single day.	If I get convinced over an idea of investment, I am just over it. My friend in investorburst.com also guides me a bit.
Scapegoat	I think I am beating inflation comfortably	I have purchased retirement ULIP plan. It will take care of my retirement.	Not exiting Infra sector funds at right time.	Investment in Highest NAV Plans.	See I am a busy man, so I have trusted friends and advisor who suggest me the investments. I follow them.
Hi-tech Lalaji	One of the best 3-year period	Retirement plan? Do I need it?	Mistake? In fact, not made any mistake in the last 25 years.	Why should I tell you? I will only tell when a business channel asks me about it.	Simple strategy is to liaison with people who know how to pull money out of money. If you have money, then you need no strategy as money will attract more money.
Mr. Cool	Not much	Yes, if I keep this consistency of my returns	I started late investing in equity markets	Generated good consistent return	Fundamental analysis and control over emotions.

Thrill & euphoria

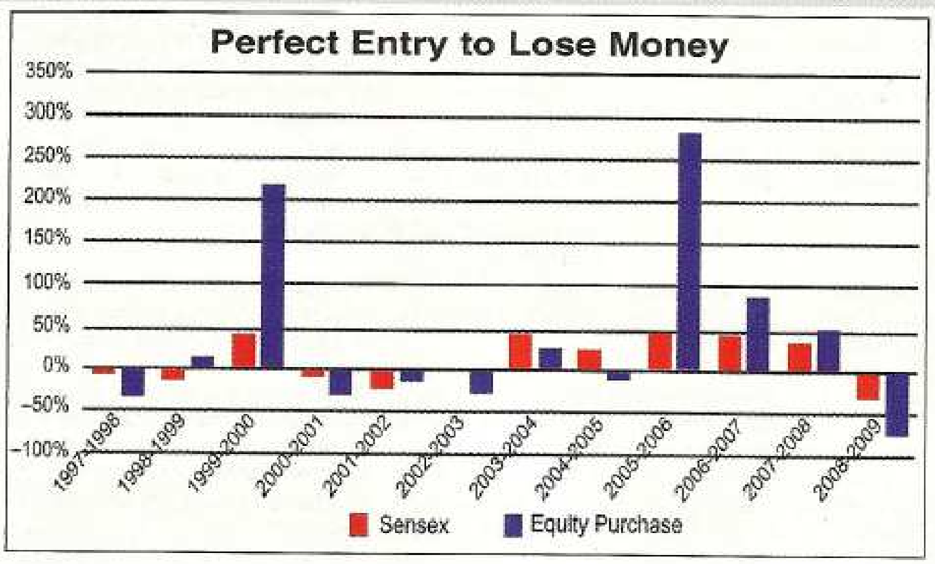
1. **Window Shoppers:** Finally again the cheating has started.... No worries it will fall to 6000 levels... then see....*He is actually saying this thing from 2005.*
2. **Seasonal Traders:** Hmmm...RNRL & RPL looks good - instead of getting into cash market, I will trade in futures... let Reliance Power get listed, my stocks will double. TV channel says Parsvnath is good with an upswing of 40% plus...let me add this one too.... Midcaps also look tempting...
3. **Scapegoat:** My agent had said that equity will give returns.... He was right.... Good analyst.... Again this time he is saying it will cross 25000 levels.... And asking me to invest in NFO of an Infrastructure fund... ok done, let's invest...
4. **Hi-tech Lalaji:** This is great time... I have made smart investments - but now, I don't have surplus money... why not get leveraged..... Let me earn on somebody else's money ...smart.... Let me get a funding in Reliance Power IPO. These pink papers and journalists are all crap; otherwise why would they come to office so early and tell me where the returns are? Market is operator-driven game..... I get tips from horse's mouth i.e. from Mumbai...
5. **Mr. Cool:** Equities are not good or bad. It's the price you pay that makes the difference. Indian story is good but the way things are moving, that's not good. PE ratio doesn't justify the present level. Read in newspaper that 1000 stocks are in upper circuit from last 7 days - fundamentals have not changed much. News from across the world is not good. Let me sell those stocks which are way ahead of fundamentals.

(cycle starts where optimism converts in excitement)
1st Sep 2007 to 14th Jan 2008 - In 4 months, Sensex jumped from 15300 to 21000 - almost a 40% rally in these 4 months.

Anxiety & Denial

1. **Window Shoppers:** .... I told you......see.... and mind you this is the BEGINNING...
2. **Seasonal Traders:** What is this .....? Broker axed my lots... He auctioned my investments without informing me.... But market will have to rise.... So I got money from my friend circle and invested.... Will repay when I recover my investments.
3. **Scapegoat:** Agent is saying that the correction phase is over... let's invest more to average the losses....so investing in lump sum as this is the best time.... He is the expert and can't go wrong.
4. **Hi-tech Lalaji:** Portfolio is down but Mumbai wale said to accumulate as recovery is round the corner.... Let me do one more thing.... Let me also get funding over the mutual fund investments too.... Earning on somebody else's money has different feeling all together.
5. **Mr. Cool:** I was right but still valuations seem higher. Let me get some positive cues and till then I should wait and watch before participating.

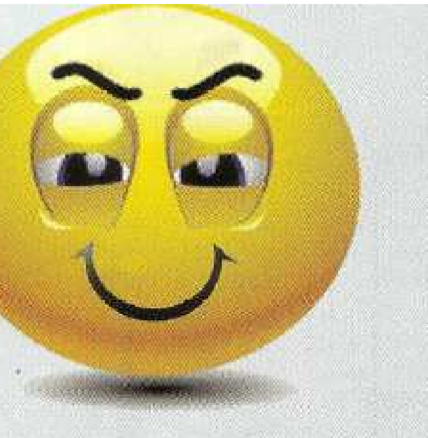
(euphoria ended & markets started drifting down)
On Jan 22, Sensex touched bottom of 15300 (same where it was on 1st September) - but this comes as a falling knife, almost 30% down in 10 days. On February 4, Sensex touched 18900. But midcaps/small caps were butchered.



ing his finances. See him - he is so rich. So I do what he does. I invest where he invests. He is my financial mentor -- now the poor subordinate fails to understand that two individuals will always have different goals, income, risk appetite and tolerance and time horizon. They think that all trains in the country ends at the capital. So just catch the fastest train available to get there. This is herd mentality.

Herd mentality can also be explained with below grid. Normally, when a person acts as member of the

Investor's Gamble		
	Alone	Group
Wrong	Very Bad	Not so Bad
Right	Very Good	Not so Good



Fear & Panic

1. **Window Shoppers:** That's the reason I don't invest much in equity (sour grapes)...that's why I withdrew my investments at 21000. Waiting for Sensex to touch 3000 levels.
2. **Seasonal Traders:** Oops I made a small silly mistake.... I should have short sold instead.... On TV they are saying it will go down more... so if I short sell now I would regain losses..... Let's do it.
3. **Scapegoat:** Oh my God.... What sin did I do...? Papa was right that equity is gambling. .... My mutual fund agent has disappeared as he is not even picking phone.... Let me call somebody else and withdraw. Also I am stopping all SIPs..... Will open a post office RD instead.... Now I swear to God, I will not invest in stock market.
4. **Hi-tech Lalaji:** This time Mumbaiwala went wrong... but that's ok... my turn will come again. Then I will recover all in one go... also he lost more money than I did... do you have a capital protection fund that protects capital but participates in upside?? Just got a call from a PMS Manager... he made 100% return in bear phase.... Let it settle, then will invest some here...
5. **Mr. Cool:** It's a great time to invest in good companies. Whether the company is bad or good, but the prices have come down for all.... This is the time for value buying.

(Market started drifting down)
In the starting of August 2007, Sensex was still hanging at 15600 levels - but worst was still to come which very few anticipated. In one and a half months, markets tanked. On October 27, 2008 Sensex touched a low of 7697. From highs of 21000, it was down by 66%. Midcaps and small caps were down almost 80-90%.

Relief & optimism

1. **Window Shoppers:** I have purchased whatever I wanted to (sourest grapes)... I never cared for the market direction... I always buy cheap as this gives the best returns.
2. **Seasonal Traders:** This time market taught a good lesson... next time I will not repeat what I did this time.... By the way which is the next IPO...? Should I invest in gold...? This is safe... let me buy a one lot of it.
3. **Scapegoat:** Mutual fund is risky.... The agent's son has taken a life insurance agency.... And he was talking about highest NAV guaranteed fund.... Concept looks good... will invest a bit here.
4. **Businessman:** Do you have some product exclusively for HNI's like me... Just heard from Mumbaiwala friend that there is lot of money in Private Equity and Venture Capital funding.... Mutual funds are rising slow... Do you have a product where I can cash on returns of property market in Dubai?
5. **Smart investor:** No reactions... It was a normal warm shiny day for him. Enjoying his life with family and planning for a holiday.

Investor had seen the worst he could have seen. Still the pain was left and many investors had already made up their minds not to look at stock markets again. Market started rising slowly but investors were redeeming money at every rise - The rise was slow but consistent. Then come THE DAY - Parliamentary Election results were out. Against the general perception of a hung parliament, Congress came with majority. 18th may 2009 turned one of the best days for the equity markets (may be not so good for short sellers) - market hit the upper circuit & trading was suspended.

group he does not feel so bad in case the decision is a blunder. So basically this is under-confidence and failure to own up to decisions, which prompts him to display a herd's behavior.

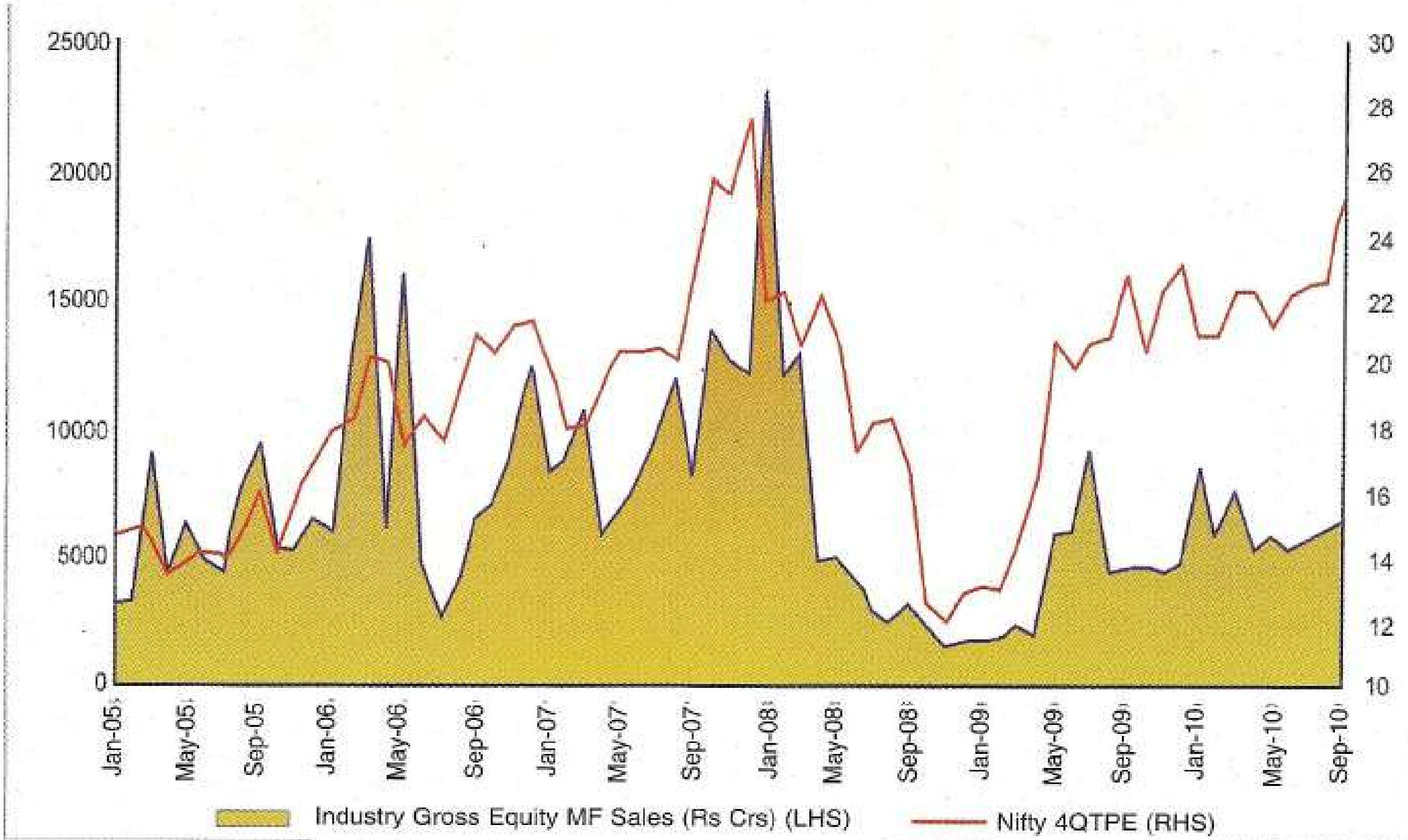
Fear of change: These people are smitten by past. Actually, they are very risk-averse. They have a very negative view about everything. They think that the markets are moving towards doomsday and any change in the momentum means loss of capital. They forget that markets do not guarantee returns and capital either.

Fear of action: They have actually made bad decisions over money issues and now they think non-action is the best action. They wait for the other person to convince them so that in case of not achieving the desired results, they can play the blame game.

Scandal sniffing: We feel this is a very dangerous symptom as these people are capable of changing individual decisions by possessing one's mind. They talk things that would shatter the investor's confidence. They would keep reminding you of the fact that "India is the land of corruption" and "market is a place for scandals and not for investors". They would constantly refer to the world history where the bubbles have burst and investors lost money. All wrong reasons are associated to justify "the forthcoming bear phase".

Information overload: When you have too many options to act, you either take a wrong decision or postpone the decision. But the irony in markets is that you will always have many options. You just need to be aware of your requirements and follow a few basic rules of investing.

Warren Buffets says "Investing is not a game where the guy with the 160 IQ beats the 130 IQ... Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people onto trouble in investing". So, to master the art of investing, you need to control the urges. But what if you cannot control them as changing basic behavior is a herculean task? Don't worry. Then you have two easy guide ways-



Diversification and Asset Allocation.

Before we move further, let us share with you an interesting instance. Last week I and a friend of mine thought of having a Gujarati thali. The moment we entered the restaurant we got the heavenly aroma and waited for the feast to arrive. I am calling it a feast, as you get a huge variety of eatables in small katoris. There we got at least 15 dishes, but in small quantities. Out of these 15, 4-5 dishes were something we disliked, so we did not eat them and then got confused over which is the main meal. So, in the end, we filled our stomach with something which was not the main meal and paid for all the 15 dishes. I later compared this to the daily meal we take. Normally, we take a fixed quantity of chapattis or rice and vegetable or salad. The variety is less and you know which the main meal is, as you never think of replacing pickle with rice. Actually, this discipline makes your platter more enjoyable and long lasting in terms of appetite.

Now just try connecting this disciplined life with investments. You will have a lot of options to invest and lot of opportunities to invest but you need to prepare a fixed roadmap and stick to it. That is your asset allocation. See where you stand in terms of your financial behavior from the adjoining graphic.

No. 1 box

It says you believe that selection of best stock or fund that will outperform the market in future is possible. Also timing the market is possible.
Who stands in 1st Box: Normally, all investors and their agents/brokers stand in this box

No. 2 box

It says best security can be selected that will outperform the market but they can't time the market.
Who stands in 2nd box: Normally, fund managers and long term investors fall in this category.

WHERE DO YOU STAND?

In which corner do you stand - just check this and your life will be easy.

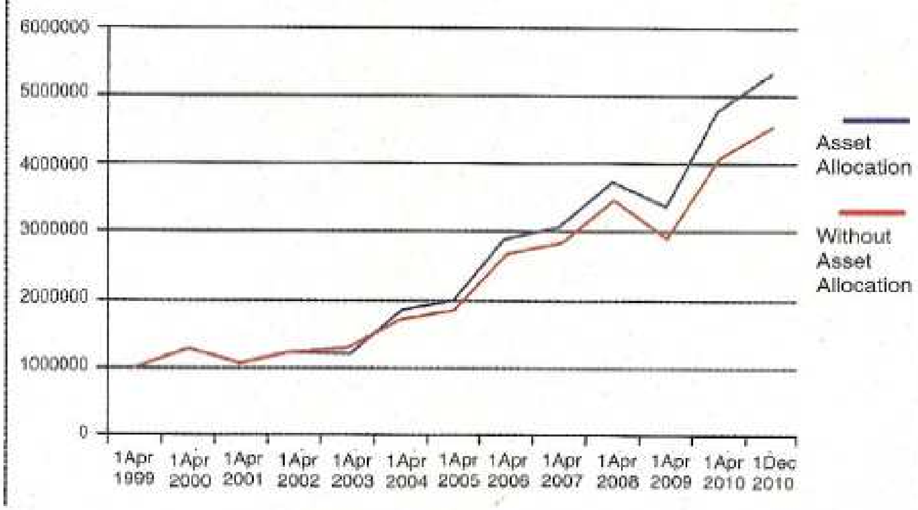
Where do You stand?		Timing of Market	
		Possible	Not Possible
Selection of Best Security	Possible	1	3
	Not Possible	2	4

No. 3 box

It says that there is no need of selecting a security for long term. They believe in timing the market - they don't see what they are investing in -- be it stock, index and commodity.
Who stand in 3rd box: Day traders & technical analysts fall in this category.

No. 4 box

This box says it's not possible to select the best security and even timing of the market is not possible.
Who stand in 4th box: People who think they are not smart and still want to easily achieve their goals.



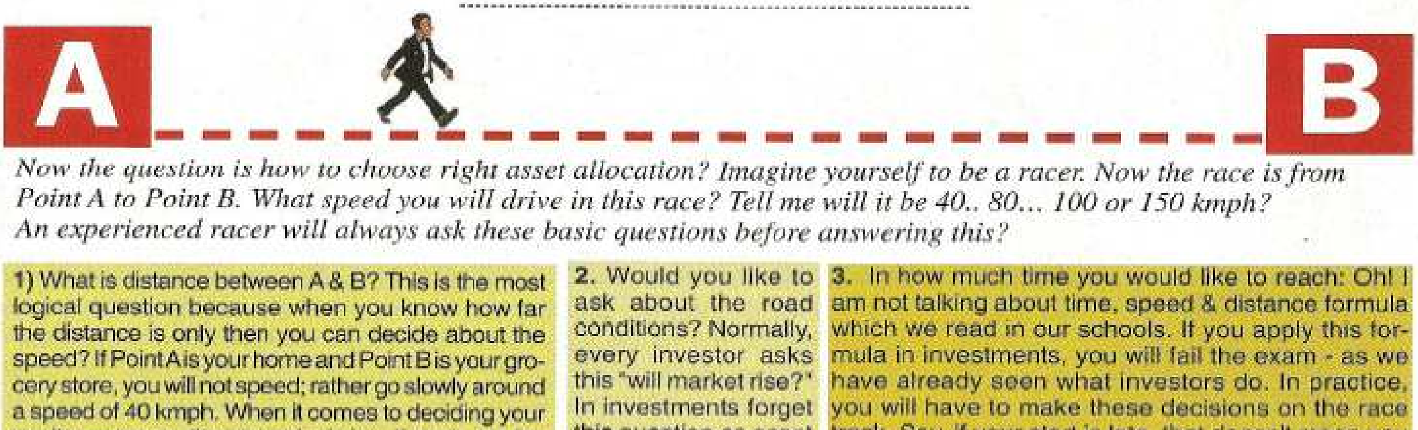
Asset Allocation	Without Asset Allocation	Rebalancing Dates
1000000	1000000	1st Apr 1999
1233364	1233364	1st Apr 2000
1101071	1076842	1st Apr 2001
1221322	1211901	1st Apr 2002
1218293	1243348	1st Apr 2003
1809825	1696932	1st Apr 2004
1988364	1845985	1st Apr 2005
2887432	2644098	1st Apr 2006
3077850	2823512	1st Apr 2007
3723127	3440719	1st Apr 2008
3365425	2899053	1st Apr 2009
4817546	4074742	1st Apr 2010
5331417	4527598	15th Dec 2010

And if you fall in Box 4, don't think you are a duffer, since 93% of the return that investors get is due to this strategy only. Only 7% is contributed by selection of security and timing of the market.Strategy is very simple but hard to stick - as they say investing is simple, but not easy. Let us now understand what asset allocation is.

Asset allocation means dividing the ratio of asset classes for investments as per the risk and time horizon of investment. The weightage of each asset class is kept constant. Once you have made this portfolio, you just need to rebalance it at pre-decided date. The profit in the asset class which outperforms is booked and the proceeds are used in the asset classes which underperform in that particular period. This is done keeping the original weightage of the asset class in the portfolio. If we see in 2007, equity gave exceptional returns. So if you would have followed this strategy, your assets would have automatically moved from equity to debt. And in 2009, when equity underperformed it would have indicated you to increase your exposure in equity. With time this strategy reduces the risk and increases return.

Just take an example where one investor invested Rs 10 lakhs in 1999 with an asset allocation of - Equity(Sensex): 50%, Debt (Kotak Gilt Fund - oldest gilt fund): 30%, Gold (Average yearly prices): 20%

If the investor maintains the asset allocation and rebalances it every year, he gets Rs 53 lakh and through buy and hold strategy he gets Rs 45 lakh. Timing of the market is even poorer strategy that we have already seen.



Now the question is how to choose right asset allocation? Imagine yourself to be a racer. Now the race is from Point A to Point B. What speed you will drive in this race? Tell me will it be 40.. 80... 100 or 150 kmph? An experienced racer will always ask these basic questions before answering this?

1) What is distance between A & B? This is the most logical question because when you know how far the distance is only then you can decide about the speed? If Point A is your home and Point B is your grocery store, you will not speed; rather go slowly around a speed of 40 kmph. When it comes to deciding your equity exposure, the ground rule is -- if goals are far, we should have higher equity exposure and if goals are for short term, we should invest more in debt.

2. Would you like to ask about the road conditions? Normally, every investor asks this "will market rise?" In investments forget this question as asset allocation strategy will take care of it.

3. In how much time you would like to reach: Oh! I am not talking about time, speed & distance formula which we read in our schools. If you apply this formula in investments, you will fail the exam - as we have already seen what investors do. In practice, you will have to make these decisions on the race track. Say, if your start is late, that doesn't mean you will drive at a speed of 200 kmph - It involves risk. So at 45 you cannot have a 100% equity portfolio.

Other factors like your past experience with equity will also determine asset allocation. One person at age 60 might be comfortable with 15 per cent equity where as another investor of same age may not like equity due to certain bad experience in the past. Also, it will depend on your comfort with the service provider. Normally, he would be your advisor or a firm taking care of your investments. Market condition at the time of investing also plays an important role. Our suggestion is that you engage a Certified Financial Planner who will draw your goals, design your asset allocation and rebalance strategy and then all you have to do is to turn on auto drive mode of your financial vehicle.

Asset allocation in modern financial planning is not only restricted to just determining your equity or debt mix. With the advent of time there are more assets which have emerged in the form of commodities, reality, exotics, arts etc. All these assets have different risk-reward characteristics and therefore open an opportunity for wide range of products to invest. But again as Chetan Bhagat says -- "Don't be serious, be sincere".

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