

Published Date:	6 Nov 2023	Publication:	WEALTH (The Economic Times) [Mumbai]
Journalist:	Babar Zaidi	Page No:	1
Circulation:	67,840		



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by Babar Zaidi

If the market corrects, will you buy or sell? Three out of five respondents to a dipstick survey conducted by *ET Wealth* in mid-October said they will invest more to gain from lower prices. But when the markets actually fell the following week, many of them retreated into a shell, forgetting the golden rule that extols them to ‘buy when there is blood on the street’.

This say-do gap might cost them an opportunity, but many retail investors could possibly be making bigger mistakes. Spurred by the stock market rally in the past two years, they have poured money into equities without adequately considering the risks involved. Many of them are new investors who have not been through a bear phase and do not have the temperament to withstand losses. They are investing after being bitten by the FOMO bug or swayed by finfluencers on

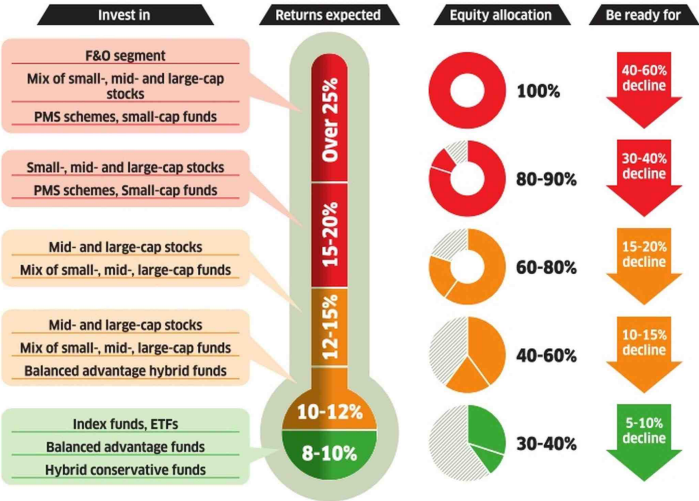
social media. “Even people who have never invested in stocks are ready to jump in,” says Deepti Goel, Associate Partner in financial advisory firm Alpha Capital. “They have changed their equity allocation thermostat from zero to high,” she adds.

Last month’s correction was a wake-up call for investors who may have taken more risks than they can digest. Though equities have the potential to deliver high returns over the long term, the allocation should not exceed the risk tolerance of the individual. Allocating more than 60% of your portfolio to stocks can yield handsome returns, but do this only if you can tolerate a 20-25% loss (see *graphic*).

Investors must also temper their expectations of returns from this asset class. Earning reasonable returns from stock investments is easier than one would think. A simple portfolio comprising bluechip stocks and a mix of equity funds can easily deliver 12% annualised returns

Your risk-reward barometer

Your return expectations should match your equity allocation and ability to withstand losses.



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DEEPTI GOEL
ASSOCIATE PARTNER,
ALPHA CAPITAL

over the long term. At the same time, earning unreasonable returns of more than 25-30% is more difficult than you think. One would have to allocate more to equities and invest in riskier instruments to earn that kind of return.

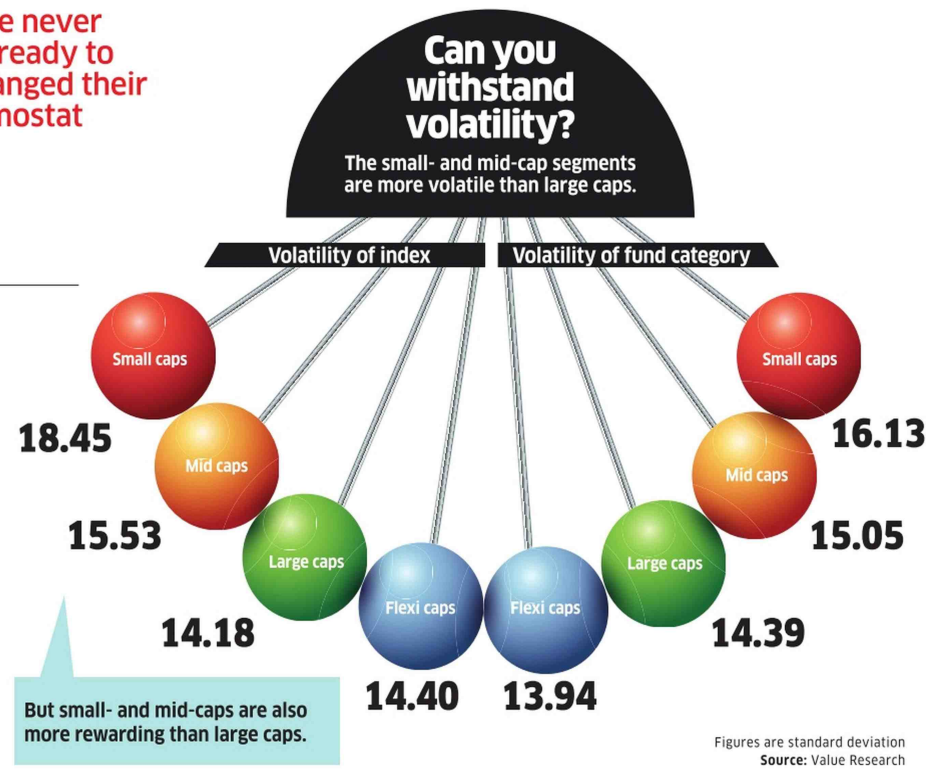
Newcomers who started investing in stocks only recently and have earned phenomenal gains may not be convinced. They expect the markets to continue their upward march. Many of them are also dabbling in the high-risk derivatives segment. Meet Rajeev Kumar (see picture), a software professional who has made close to ₹2 lakh from stock trading in the past two years. Kumar buys and sells stocks very frequently using a mobile trading app and has positions in almost 12 scrips. “The app alerts me about stocks to buy and sell, helping me generate handsome returns,” he says.

Six months ago, he entered the F&O segment after seeing social media posts about option trading. However, his foray into index options has not been very profitable. Still, Kumar expects to eventually learn the ropes and make money. Experts believe investors such as Kumar are set up for failure. “These new investors will learn their lessons the hard way. Newcomers always give tuition fees to the markets,” says Abhishek Gupta, Founder and CEO of Mumbai-based wealth advisory and PMS firm Moat Wealth Associates.

Reduce small-cap exposure

Choosing less volatile stocks and funds is one way to cut the portfolio risk. The small- and mid-cap segments have generated the highest returns and also witnessed huge inflows in the past year. However, these stocks are more volatile than large caps (see graphic). We must put in a caveat here. Volatility should not be confused with risk. It is only an indication of how much the price fluctuates over time. The real risk is when volatility pushes an investor to turn a notional loss into a permanent one (see story on page 6).

As it turns out, new investors are more vulnerable to committing behavioural errors triggered by volatility. They have not been through a bear phase before and don't have the temperament to withstand losses. They suffer from acute seasickness when markets turn choppy and usually



Concentration vs diversification

The five worst performing Nifty stocks and funds in the past year.

STOCK/FUND	27 OCT 2022	31 OCT 2023	CHANGE (%)
Adani Enterprises	3,325	2,294	-31.02
LTI Mindtree	6,912	5,072	-26.62
UPL	706	542	-23.35
Infosys	1,524	1,365	-10.4
Eicher Motors	3,711	3,332	-10.2
Kotak Mahindra Bank	1,865	1,732	-7.16
Nifty	17,737	19,077	7.6
Axis Focused 25	45.40	46.48	2.39
Axis Bluechip	49.33	51.70	4.8
LIC MF Large Cap	44.27	46.63	5.33
UTI Flexi Cap	249.38	263.20	5.54
Taurus Largecap Equity	112.30	119.03	5.99
Flexicap category	-	-	13.28



Rajeev Kumar

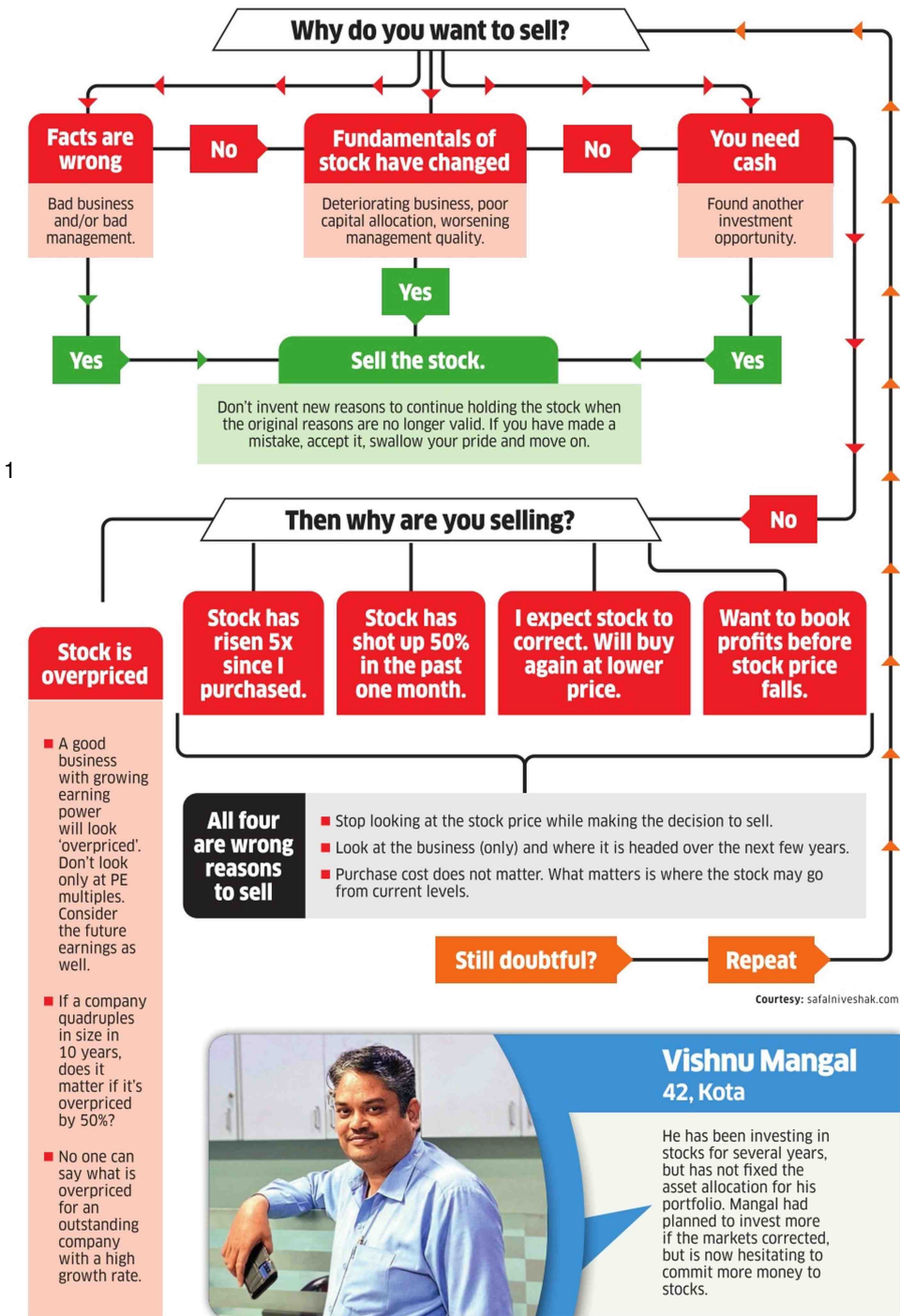
28, Pune

Though this software professional invests randomly, he has made good gains in the past two years. He also dabbles in option trading, but has not been very successful. Rajeev does not follow any asset allocation and relies on social media for information on stock markets.

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Before you sell your stocks

Planning to sell your stocks? *Safalniveshak.com* helps you make the right decision.



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We examined the performance of mutual funds and individual shares in the past year. The five worst performing Nifty shares dropped by an average 18% in the past year, even though the index rose by 7%. Mind you, these are not obscure penny stocks, but constituents of the Nifty 50 index. During the same period, the worst performing flexi-cap equity funds delivered low but positive returns for investors. "Some investors have a mindset against mutual funds. They don't want to give up control, even though they can't outperform the fund manager," says Goel. For these investors, the choice is between earning better returns by entrusting their money to a mutual fund or investing on their own and losing money.

The risk in stock investing is not only from poor stock selection but also short tenures. If equities are held for the long term, the possibility of losses comes down significantly. This may not apply to individual shares, but is certainly true for equity funds. In fact, a Crisil study shows that instances of losses are nil if SIPs in equity funds are continued beyond five years. If you don't need the money for the next 5-6 years, don't hesitate to invest in equity funds through the SIP route. Answer the questions on the left to know if you should be selling your stocks now.

Rebalancing the portfolio

Have you also taken more risk than you can handle? One way to control risk is by rebalancing the portfolio and restoring the original asset allocation. Backtesting studies have shown that investors who regularly rebalance their portfolios and stick to a predetermined asset allocation tend to do better than investors who keep their portfolios static and let them flow with the market. "This, in turn, helps in boosting the investor's confidence. When the markets tumble, a rebalanced investor is less likely to panic and more likely to remain invested," says Raj Khosla, Managing Director of MyMoneyMantra.

It is advisable to rebalance the portfolio at least once a year, preferably at the end of the financial year or after a big change in asset prices. Disciplined investors who rebalanced their investments when the Nifty crossed 20,000 in September would not have been as badly hurt by the downturn in October. In fact, they can now buy back the stocks at lower prices. One such investor is Amit Maheshwari (see picture). Though he is bullish on equities and has built a sizeable portfolio by investing small amounts in stocks and equity funds, Maheshwari regularly books profits to ensure that his allocation to this volatile asset class does not exceed 60%. When markets decline, he is ready with dry powder so that his equity allocation doesn't fall below 40%. "Regular profit booking helps me rebalance and control the risk in the portfolio," he says.

Use F&O to hedge

If you have a significantly large equity

Derivatives can cushion your portfolio

Here's how much Nifty puts of different strike prices will yield.

PUT OPTION STRIKE PRICE AND EXPIRY DATE	CLOSING PRICE ON 3 NOV (₹)	COST OF 1 LOT OF 50 (₹)	GAIN OR LOSS IF ON 28 DEC NIFTY CLOSES AT...			
			18,000	18,500	19,000	19,500
Dec 28 PUT 21,000	1,578	78,900	71,100	46,100	21,100	-3,900
Dec 28 PUT 20,500	1,105	55,250	69,750	44,750	19,750	-5,250
Dec 28 PUT 20,000	671	33,550	66,450	41,450	16,450	-8,550
Dec 28 PUT 19,500	355	17,750	57,250	32,250	7,250	-17,750
Dec 28 PUT 19,000	175	8,750	41,250	16,250	-8,750	-33,750

Use options only to hedge. Speculative positions can lead to losses.

Figures are Nifty put option quotes in ₹. Data as on 3 Nov 2023.



"Volatility is not risk. It is simply the fluctuation in stock prices. The real risk lies in turning a notional loss into a permanent one."



NEHAL MOTA
CO-FOUNDER AND CEO, FINNOVATE

"Rebalancing helps in boosting the investor's confidence. When the markets dip, a rebalanced investor is less likely to panic and more likely to remain invested."



RAJ KHOSLA
MANAGING DIRECTOR, MYMONEYMANTRA

portfolio, you should consider using derivatives to hedge the portfolio. Buying put options can cushion your portfolio against a drop in the stock market. A Nifty put of strike price 19,000 and expiring on 28 December is currently quoting at ₹192. The cost of one lot of 50 shares will be ₹9,600. If the index crashes to 18,500 by that date, the buyer gains ₹308 (or ₹15,400 per lot). However, if the index doesn't fall below 19,000, the option expires at zero. Consult a qualified investment adviser to know the best strategy to hedge your portfolio using derivatives.



Amit Maheshwari
50, Delhi

This former IT engineer is bullish on equities and invests regularly in stocks and equity funds. At the same time, he ensures that his equity allocation is within **40-60%** of his investment portfolio. The recent downturn has hurt his portfolio, but Maheshwari is not worried.

Unfortunately, most participants in the F&O segment don't use options to hedge their portfolios, but for speculation. Trading in derivatives has increased by leaps and bounds in the past five years, rising from ₹8.5 lakh crore in 2018-19 to ₹108 lakh crore in 2022-23 on the NSE alone. The average daily premium turnover of index and stock options is ₹46,377 crore on the NSE. No wonder stock exchanges want to extend trading hours for derivatives.

Don't let influencers charm you into buying options and earning high returns. In most cases, they are touting misleading

figures and unverified claims. Only last week, Sebi banned three such influencers from selling their trading course and asked them to return the fee they had collected from investors.

Think of it this way: If anyone can accurately predict the market movements, he can make crores of rupees and it won't be necessary for him to sell trading courses to others for ₹5,000-6,000.



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