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INVESTING

Are Anchors For Real?

Let us judge companies by their ability to reward shareholders

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In times of continuous change and uncertainty we are seeking permanency. This is why forecasts play a dominant role in one's decision making. We just had our Budget session, and before that we had numerous debates and discussions on different business channels. All of them kept forecasting, but, hardly any of those forecasts have come true. Why do people forecast? It is because we human beings are always over-confident of our knowledge and abilities. However, evidence shows that most of the forecasts are wrong, especially in the financial markets. Did the 'India shining' story hold true, did the tech boom last, did the bricks and mortar companies just vanish, did the BSE Sensex touch 30,000? These are just a few examples of forecasts going wrong.

How many times did you go wrong on a stock or an IPO which was expected to go up? Given the dreadful track records that can be seen, it begs the question of why we bother to forecast

. The answer lies in a behavioral trait known as anchoring effect. In the face of uncertainty we cling to any irrelevant number for support. Let's take the case of Sensex movements and how the anchoring effect works. We encounter this question regularly: Is the market up, or down? If the BSE Sensex and the Nifty is up, prompt comes the reply—the market is up. Anchoring effect is at work. The BSE Sensex is of 30 stocks and the Nifty of 50 stocks. Can it be the benchmark for over 6,000 stocks that are listed? We are so anchored by a fixed set of numbers that we see it as a representative of the markets. It is possible that even if the indices are down your portfolio of stocks could be up. Most investors have mood swings with the market swings, and this distorts their thinking. This is like following the thumb rule.

Failure in forecasts show that in the face of uncertainty we cling to irrelevant numbers for support

How many times have you heard investors say they only invest in blue chips? What is a blue chip? It is an anchor which investors use to denote that they invest in good stocks. There is nothing like a blue chip in the stock markets. Remember these names—Scindia Steamships, Century, Orkay, Mafatlal Fine, Standard Mills, Gwalior, Mafatlal Industries, Phillips, ACC, Mazda, Zee Tele, Satyam, Bombay Dyeing, Ashok Leyland, Indian Organic, Great Eastern, Arvind, Global Tele, GNFC, Indian Rayon, Hindustan Motors, Mukand, GSFC, Tata Chemicals, Visual Soft, Voltas. Once upon a time they were also blue chips and markets used to open with these names. But now, they are no longer the blue chips. Investors need to know that there are no permanent blue chips.

Markets go through different phases. In every bull phase there is a different theme. Let's take the instance of valuation techniques. During the Harshad Mehta boom we had the replacement theory at work, which became the anchor for investors valuing companies. During the tech boom we had the eyeballs theory, and it became the anchor. Then we had the growth story doing the rounds in 1993 to 1996 where high P/E signified growth and investors paid any price for growth stocks.

Ultimately, in stock picking, the price you pay for the right value is important. As for me, I would consider the dividends paid by a company as a sustainable anchor to be alert. Once the dividend yields drop significantly it is a sign of a bubble in the making. Bear markets offer high dividend yields and that is the time values are available. Earlier, when there was not so much of information in flow and technology at work, how did one evaluate a company? Only by the dividends it paid. It meant that the company was profitable and able to reward its shareholders. A bee for its honey, a chicken for its eggs and a stock for its dividend. Understand anchoring bias and use it to your advantage.

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