



INVESTING

# Negotiating Minefields

A rational approach is the only way to counter availability biases while investing

PARAG PARIKH

In the last issue, we discussed how representativeness distorted our decision-making process. The other big distorter is the availability bias. We tend to make decisions on readily available and vividly displayed information. Go back five years, when the India Shining story was doing the rounds. We only came to know that India was not shining, as propagated, when the ruling NDA government lost the elections. However, the vividly displayed information on India Shining was so strong that everyone believed it.

So is the case in the markets. Last year there was fear all around and the media and social forums all talked about the global recession

. Gloom prevailed. It was as if the world was coming to an end. Since all the information was negative, we started thinking negatively. The stock prices were down. Everyone was selling stocks, as they represented losses. Stocks became so cheap that they became great values. Nothing drastic had happened to the companies, but the stock prices were beaten down. A rational investor would find the stocks attractive and least risky as he was buying them at rock-bottom prices. However, availability heuristic was at play. Investors were guided by negative news and thus did not see the opportunities. So, the next time you come across such buying opportunities ask yourself: are my decisions based on vividly displayed information? Am I processing data rationally?

**The divestment story and people buying divested PSU stocks at any price has no rationality**

The latest available and the most talked-about is the government's intention to divest in some public sector units. But what is happening to the stocks that may come up for divestment? They are hitting the roof. The rise in PSU counters varies from 30 per cent to 400 per cent.

Consider PSU divestment. The government will offload stocks to the public. At what price? Around 5 to 10 per cent discount to the prevailing market price. What happens next? More stocks come in to the market. Should the price of the stock go up or down? Definitely down. Why are people buying PSU stocks? Because everyone is buying. The divestment story and people buying PSU stocks at any price has no rationality.

You can't buy PSU stocks at any price on the hope of divestment. Secondly, you should not blindly apply for the IPOs of such companies, as they would be offered to you at high prices due to the runup in PSU stock prices. Expect to be offered PSU divestment stocks at over 20 times earnings. Expensive!

Be wary of all the information fed to you, like the issue getting oversubscribed x times, the big institutions and mutual funds having put in applications and such. Don't rush on such information. Their investment decisions may be based on various other considerations. Moreover, they are putting other people's money, not their own. At the end of the day, investing is all about buying something at the right price.

Mutual funds with regular dividend plans are very popular. This popularity is based on the available information that you will get an assured dividend which is tax free. However, the fact is after the dividend payout, the NAV goes down to the extent of dividend paid. So, in fact, you have been given your own money back as dividend.

There are certain pointers you must bear in mind to spot such availability biases. What is the press regularly reporting? What advertisements do you see frequently? What are the brokers recommending? What are the consistent recommendations of your favourite TV channel? Where is the herd going? Do your homework before you act on such available information. Don't follow blindly. In short, don't do what the majority is doing.

The author is chairman, Parag Parikh Financial Advisory Services feedback AT outlookindia.com

<http://money.outlookindia.com/article.aspx?264427>

ABOUT US | CONTACT US | SUBSCRIBE | ADVERTISING RATES | COPYRIGHT & DISCLAIMER | COMMENTS POLICY

