

Penny For Your Thoughts

... That's what you get when you let greed run over reason, says Parag Parikh

THERE are some universal principles which are timeless. But, we tend to forget them in good times. Take the last two years, for instance. The stock market has been moving up only north and all the available heuristic in such a situation was only positive. Only a couple of weeks back, we heard people predicting sensex at 10000.

Then what explains the drastic erosion in stock prices now? The economy is still forecast to grow at over 7%. Corporate results are also good. The reason is simple. The sentiment has changed. Why? FIIs are selling. But is it not common sense that anyone who buys will some day sell? This was a predictable surprise. Were you not warned that getting in to penny stocks was very dangerous? You also knew the dangers but you wanted to ride the wave thinking that you will exit at the first sign of weakness. But, then everyone was thinking the same. When the time came to sell everyone wanted to sell, but alas there were no buyers. Why did you get trapped?

It was because of your greed. You wanted a ten bagger; you wanted to make a fast buck. Now you go and blame the penny stock companies for your woes. But one needs to remember that someone smarter than you exploited your greed and, thus, you are holding worthless stocks. Had you not been greedy and had common sense to understand that there are no short cuts in life, you would not be nursing your wounds today. We all make mistakes, but the important thing is to learn from them and not repeat them.

Now we come to this crucial question of why is the stock market so unpredictable? Why is there so much of volatility? Why are stocks going down in spite of the good results? What has really happened to wipe out crores of rupees worth of market capitalisation? Why the stocks recommended by reputed fund managers and analysts are also going down?

► **Bulldozed: P2**

Bulldozed

From Page 1

THE reason is very simple. We believe that the market is efficient and people make rational decisions to maximize profits and this is what we have been taught in schools and colleges. The fact is that the market is not efficient or else how could stock prices of companies fall in spite of good results? Or how could stock prices of penny stocks rise in spite of companies having no business or mediocre performance.

Another fact is that people do not make rational decisions to maximize profits. If it were so, then how would one explain the act of people giving to charities or celebrating a birthday or an anniversary? These are definitely not profit-maximising acts.

It is assumed that human beings make decisions out of their mind and that is the reason that they make only rational decisions. But, we human beings also have a heart and this makes us emotional beings. So, there are times that we get swayed away by our emotions and make emotional decisions. These decisions will not be in conformity with our mind decisions and hence may be against our financial well-being. It is precisely for this reason that smart people also make big money mistakes.

It is important that you learn to control your emotions when you are an investor in the stock market. At present the stock market is gripped by fear and investors are paying for the excesses committed during the greed phase. So, now would you agree with me when I say, "Analysis does not work in the market, but the jobs of the analysts are secured". You require someone to give reasons as to why something has happened and keep the media busy.

Remember the following points when investing in the market:

1. Sentiments change overnight as people are emotional.
2. If analysis really worked the markets would become very boring. They are interesting because we cannot predict human behaviour.
3. When you get information on a stock find out if the market already knows it. Know your level of information ladder.
4. Life is never fair. You may find incompetent people being highly successful. Don't feel bad. They are reaping the rewards of their past karma.
5. You cannot get investment opportunities every day. A couple of them in a year would be great.
6. Patience is always rewarded. The law of the farm is applicable in all walks of life.
7. Control your emotions. Do not follow the herd blindly.
8. You never miss the bus in the markets. If you have the money opportunities will always come. Preserve your money.
9. Bear markets offer good investment opportunities rather than bull markets.
10. Avoid margin trading. You are only enriching your banker or the broker. Ask your margin trading friends how they are treated in the current market situation.
11. Derivatives are good hedging instruments. Unfortunately they are used as speculative instruments. They only enrich the intermediary at the expense of the investor. Avoid them.

The markets have had a steep climb very rapidly. For every action there is a reaction. Hence we will have to be prepared for a steep correction. The excesses will have to be corrected as they were against universal principles. But the silver lining is that such times will also offer great opportunities. Still the equities, as an investment class, are the most tax efficient. I am sure there are exciting times ahead. Wishing you all a Happy Diwali and a Prosperous New Year.

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