

Trading is not investing

THE day's headline is about how FII buying drove Sensex up 162 points.

Parag Parikh would only be too happy. For, he'd written in January, "The year 2005 marks the beginning of the Indian equity tidal wave, which will also attract international investment companies to set up bases in India," in the preface to his new book "Stocks to Riches," from Tata McGraw-Hill (www.tatamcgrawhill.com), offering 'insights on investor behaviour'.

One of the first myths that Parikh breaks is that trading and investing are one and the same.

No, they aren't, he says. "We find so many people focussing on a product, say stocks, and a procedure, trading, but they do not have an investment plan in place.

Most people are trying to make money by what they think is investing. But trading is not investing; it is only a procedure or a technique."

Trading provides liquidity to the market, but it can become 'overwhelming and confusing' when you are not clear about your investment plan, cautions the author.

The plan he talks about is not a one-shot affair, but a continuous process, because we live in times of constant change. Also, our goals change with circumstances, "requiring us to reweigh our options," notes Parikh.

Investment plan demands "discipline to stay the long-term course and patience to achieve the desired outcome." Getting carried away by the greed of quick returns can destroy wealth, as it does not conform to nature's law, counsels the author, weaning the reader from speculation.

He cites as example three companies, viz. HLL, Hero Honda and Infosys, to prove how patience can be a virtue. "Hindustan Lever has given a CAGR (compounded annual growth rate) of 21 per cent in returns for the last 13 years, whereas Hero Honda has given 41 per cent," informs Parikh, crunching numbers that factor in dividends too.

"Infosys has delivered an astounding 79 per cent annual re-

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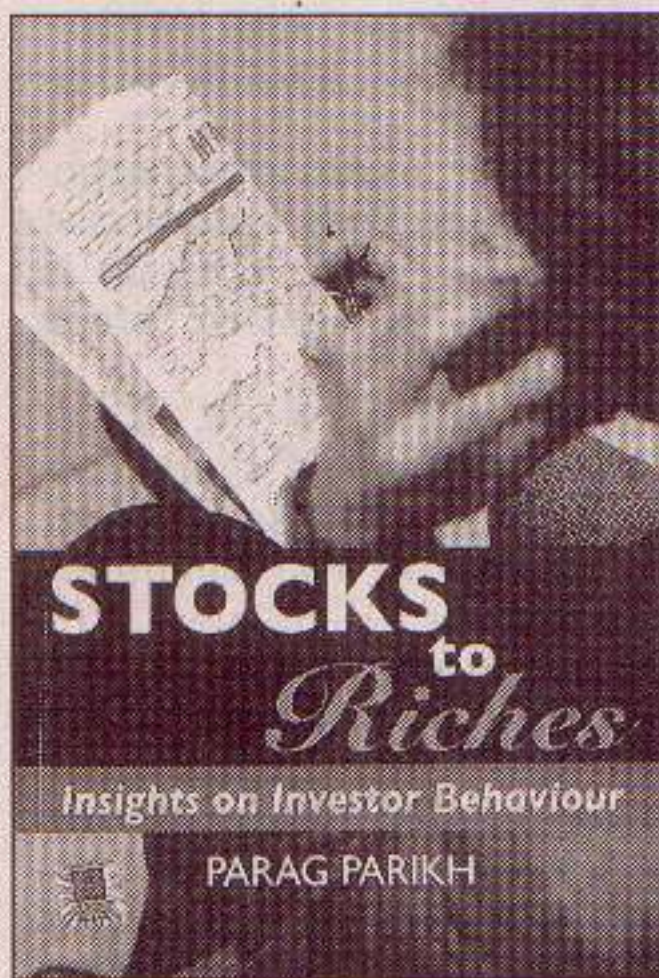


D. Murali

turn to shareholders since its listing 11 years ago."

A chapter titled 'Three ways of investing' begins with 'the intellectually difficult path' to achieve superior results. This is for those who "have a profound understanding of investing, can see future trends clearly, and can comprehend business and the environment." These are long-term investors, with an eye on cash flows rather than capital gains and, therefore, unperturbed by rumours and gossip that create short-term volatilities. Behind this approach lies hard work to constantly explore opportunities, "by talking with management, examining different viewpoints on business, and trying to understand economic policies."

The second path is 'the phys-



ically difficult' one, which most people follow. "They keep in touch with a number of brokers as they believe it will increase their efficiency in the stock markets. They are overloaded with information. They are constantly on the telephone making calls and receiving more calls," narrates Parikh. These people continuously monitor stock price movements, carry home huge reports to read before the next day, he'd add.

"In every way they expend tremendous physical energy and effort to beat the market by outmanoeuvring the compe-

tion. But they don't realise that others are also doing the same."

The current volatility in the markets is the result of too many people trying to invest by this method, comments the author.

"Life is simple. We make it complicated," he rues.

The third is 'the emotionally difficult' one, which is 'straightforward'. Simply work out a long-term investment policy that is right for you and be committed to it, advises Parikh. But this needs a lot of emotional discipline. "It often pays to go against popular opinion."

Learn to think with your emotions, rather than have your emotions do the thinking, he counsels.

The new competitive edge, according to the author, is 'understanding human behaviour and identifying mis-priced securities'.

Remember that the prospect theory, 'one of the key pillars of behavioural finance', won the Nobel Prize for Daniel Kahneman and Amos Twersky in 2002.

Take the mini test in chapter 5 to know if you are 'a victim of loss aversion and sunk cost fallacy'.

Cure lies in sage advice such as: check your appetite for loss, diversify, develop total portfolio vision, let bygones be bygones, and so on.

Another anomaly is 'decision paralysis and the endowment effect'.

The phrase 'mental accounting' may sound like a strength, but it "underlines one of the most common and costly mistakes people make when dealing with money".

This glitch shows as "the tendency to place different values to the same sum of money depending on how it has been acquired and the effort required to acquire it."

A simple take-home idea towards the end of the book is to set apart the bulk of the portfolio to stocks, especially "if you don't plan to tap into your long-term savings for at least 5 years."

Eminently readable.

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