

INVESTING

Learning From Past Mistakes

Here are some common behavioural mistakes which we should overcome to stay in control of our investments

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Tough times bring with them valuable lessons and also give you the chance to learn from your mistakes. The recent slowdown and the market crash exposed a lot of behavioural follies, which are common to most of us. I discuss a few of them here.

Herd behaviour. When we are not sure of ourselves, we end up taking decisions based on what others are doing. We mindlessly follow the popular trend only to land ourselves in a mess. When the markets were going up, a lot of us bought because everyone was buying. We started chasing stocks and paid higher prices for them. When the markets started crashing, we started selling because everyone was selling

. Because we followed the herd, we went against the basic principle of investing: Buy when prices are low and sell when prices are high. Next time go against the herd.



Availability bias. We tend to take decisions based on readily available and vividly displayed information. Thus, we get swayed by information provided by the media. Switch on to your favorite business channel and you will see experts giving opinions on the way the market will behave and making stock recommendations. Even the anchors, whose job is to disseminate information, make predictions. All their predictions and tips are based on the movements of the market indices. You need to understand that real market experts do not give stock tips daily. Learn to differentiate between information and knowledge. Did any of these so-called experts recommend you to buy when the markets were down and stocks were available at bargain valuation?

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Representative thinking. We tend to base our decisions on 'representativeness' or similarity. This is where a lot of investors got stuck with expensive stocks. A good company may not necessarily be a good stock to buy. Investors thought that they were buying a good company and paid any price for the stock only to nurse losses when the markets crashed. Similarly, investors bought stocks because FII's were buying.

Investors also failed to distinguish between an investment advisor and a salesman and ended up with a pile of junk investments. Fund managers would talk about the long-term approach to their investment philosophy and some would quote investing gurus like Warren Buffet and Peter Lynch. A look at their investment portfolios and the churn ratio would call the bluff. Most of them were sitting on cash when the markets were offering great bargains. Representative thinking led a lot of us to believe that all fund managers are expert stock pickers.

Current fads and fancies. Investors should be careful not to be swayed by the current fancies in the market. In the past, your losses would most probably have come from stocks of real estate, power and infrastructure as these were the fancies of the market. Such fancies quote fancy prices as they have high built-in investor expectations. How does one spot such a fancy? It's simple: mutual funds start introducing schemes, IPOs hit the markets and the media starts talking about them. The current fancy seems to be infrastructure. Many infrastructure MFs are already on offer. Infrastructure stocks are already up more than 50 per cent from their lows.

Overconfidence. Stockmarkets rise or fall according to market sentiments. When a portfolio appreciates along with rising markets, the investor gets a false sense of confidence about his ability and knowledge. This can lead to overconfidence and, subsequently, rash decisions which can ultimately lead to losses. Similarly, when the markets are going down and when one's portfolio starts depreciating, fear strikes, leading to loss aversion. In such a situation, the investor tends to run to safety and prefers fixed income instruments over stocks. He starts selling the winners and holds on to the losers. Investors need to understand the nature of the markets and maintain equanimity to be successful in volatile markets.

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