Investing in Equities (BASIC GUIDE)

Q. What is meant by ‘Investing’ and how is it different from ‘Savings’?
Ans. 'Investing' means building up to meet future consumption demand with the intention of making profits while 'Saving' is not consuming everything today and leaving something for tomorrow. When we 'invest', we forego our present consumption or do it out of our surplus. In other words, 'savings' again supports 'investment'. When you invest your savings it has morphed into Risk Capital which can be eroded. Risk can be minimized by choosing to invest in low risk investments. The risk associated with each investment changes with time, and must be monitored carefully.

Q. What is Equity Investment? Is it the same as investing into stocks or shares?
Ans. Equity Investment means investing in shares of the company, which are listed in the stock market.
Yes the word equity, stocks and shares are synonymous and investing into equity also means as investing in stocks or shares of a company.

Q. What is a Share?
Ans. A share is a single unit of ownership in a company, mutual fund or limited partnership. When you purchase shares, you become part owner of a company. As an owner, you are usually entitled to voting rights and to a share of the company's profits, a portion of which are distributed in the form of cash dividends. Dividends are not guaranteed. They may be increased if the company performs well, but they may also be reduced or eliminated if the company performs poorly.

Q. What is a Company? And what are the different types of Companies in whose shares investments can be made?
Ans. The Joint Stock Company is a legal entity whose capital is contributed by various stake holders into that company in lieu of shares allotted to them. According to the Companies Act broadly there is Private Limited, Public Ltd., and Listed Public Ltd Companies., in first 2 categories public is not widely invited to invest into the shares of the company and hence they are closely owned company. While in third case only public is widely invited to own the shares of the company, by way of initial public offer and then they are listed on the recognized stock exchanges like Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). Say for example company comes with an initial public offering of 1 crores shares of Rs.10/- each out of which an investor is allotted Rs. One lakh shares of Rs.10/- each on application being made by him in an IPO offering and hence now an investor owns 1% of the company’s capital i.e. Rs.10 lakhs.

Q. Should we invest in Stock Markets?
Ans. The answer to this question is a definite yes. Although past performance cannot guarantee future market results, stocks historically have outperformed all other long-term financial assets. It is the only financial asset that has significantly outpaced inflation over time. The only important factor to be kept in mind is that investment should always be made with an objective in mind and we should not be too greedy while investing.

Q. What is the difference between a Primary and Secondary Market?
Ans. Any company who wants to raise its capital for its business approaches the public at large with an offer to issue and allot certain number of shares at certain prices. This is called as an initial public offering by the company in the Primary market.
Once these shares are allotted they get listed in the recognized stock exchanges where trading in the value of the shares take place in free market place by large number of buyers and sellers. This market place is called as a Secondary market. Currently on a nationwide basis BSE and NSE provides an on line trading platform to trade in Secondary market.

Q. How one can invest in Shares?
Ans. (i) Direct Route: One can open an account with any BSE or NSE Broker and buy and sell shares in BSE or NSE directly. Investing directly calls for a bit of knowledge about the company and its business. One can also depend on research based advice given by his broker. Further one should have enough time to track his investment regularly. If you do not have these essentials it is advisable to opt for a professional to manage your investments via Portfolio Management Services (PMS) offered by any Investment Advisory Companies.

(ii) Indirect Route: One can invest into Mutual Fund which in turn invests into the stock market. Mutual Fund collects the money from the large number of small to big investors and then invests that money in equity shares. They possess requisite skills and expertise to do this job for which nominal asset Management fees is charged by them on total corpus. Those who don't possess requisite skills and time. Mutual Fund is ideally suited for them.

Q. Who should invest in Stocks and in how much proportion?
Ans. Generally younger people are considered ideal candidate for investing in shares since they have more risk taking capabilities than elder one. The thumb rule is to deduct your age from 100. Ideally your equity exposure should be that figure. For example, if you are 30, your equity exposure should be 70 (100 – 30). One should reduce equity exposure with advancing age, however, lately because of increase life expectancy and cost of living experts advise to have at least some exposure to equity in all ages.

Q. What is a Right of the equity share holder of a Company?
Ans. As an equity share holder one is entitled to a dividend if declared by the company. One is also entitled to the rights or bonus, shares declared by the company. Besides that, one has the right to cast his vote in a General Meeting on a various resolutions.

Q. What are the different kinds of risks one should consider while investing?
Ans. Risk in investments can be of the following types:
? **Market Risk or Volatility:** This refers to the fluctuation in the value of investments due to changes in the price of the stocks included in an investor's portfolio which could be caused by a variety of factors such as performance of the company, policy announcements, political factors etc. Even a portfolio of well-diversified assets cannot escape all risk.
? **Inflationary risk**: Also known as purchasing power risk, this is the decline in the purchasing power of money over time, so that even the "safest" investments can leave investors with substantially less purchasing power. For example, assuming an inflation rate of 4% for the next 10 years, if you have Rs.100 today, 10 years from now inflation will have eroded that Rs.100 so that it is worth only Rs.68.
? **Investment or credit risk**: This is the possibility that a company in which an investor is invested in may not be sufficiently profitable to remain in business.

Another manner of classifying risk in securities is as follows:

? **Unsystematic Risk:** Unsystematic risk affects a very specific group of securities or an individual security. Internal risks such as strikes, management policies, etc. are to a large extent controllable and are examples of non-systematic risks. An investor can easily manage such non-systematic risks by having a well-diversified portfolio spread across the companies, industries and groups so that a loss in one may easily be compensated with a gain in other.

? **Systematic Risk:** The risk inherent to the entire market or entire market segment is called Systematic Risk. It is also known as "un-diversifiable risk". Such risks are external and beyond the control of the company. Examples of such risks are economic, political and sociological changes. Their impact is on prices of all individual stocks and they move together in the same manner. Therefore quite often the stock prices may be falling despite good company performance and vice versa.

Since higher returns are associated with higher risks, you, as an investor, need to understand your risk tolerance level and certain principles of investing which can help you diversify and mitigate this risk. Before venturing into the world of stock investments, consider:

? Are you conservative, aggressive or speculative in your approach to investing?

? Are you comfortable owning aggressive stocks?

? Are you looking for a steady stream of income, long-term returns from growth or very high returns from risky short-term trading?

Factors affecting Investment decisions

Before you begin investing, it's helpful to understand some of the factors that will affect your investment decisions, such as:

? Risk
? Liquidity
? Time Horizon
? Total Return
? Diversification
? Tax Consequences
? Rupee Cost Averaging

Risk: Risk in investments can take various forms.

Liquidity: A "liquid" investment is one that can be readily turned into cash if you need the funds on short notice. Investments can vary greatly in their degree of liquidity. Shares can be traded on any business day at their current market value, which may be more than, equal to or less than the amount initially invested.

Time Horizon: Different investors have different time frames in which to achieve their investment objectives. Generally, young investors with long time horizons should be able to assume greater risks because they have more time to offset any losses with the higher return potential of investments with greater risk. Older investors, however, often choose to reduce risk because they have less time to recoup losses.

Total Return: All investments provide one or a combination of two different types of returns to investors - income or growth. Income is the dividend earned from stocks. Growth is the price appreciation of the security. The total return of an investment is the combination of income and growth realized over a given time period. In selecting investments based upon their expected total return, you should understand which portion is generated from income and which from growth. Usually, the greater the reliance on income, the lower the market risk but the greater the long-term purchasing power (or inflationary) risk.

Diversification: Building a diversified portfolio with securities spread across different investment classes can help you avoid the risk of having all of your eggs in one basket. By mixing industries and types of assets, you spread your risk. A particular market condition may have less impact if your portfolio consists of a wide assortment of securities than if you purchase only one type of security.

Most beginning investors don't have sufficient capital to properly diversify their portfolio by purchasing individual securities. Investing in mutual funds allows you to buy a professionally managed, diversified portfolio with relatively small rupee amounts. In addition, many mutual funds allow you to take advantage of rupee cost averaging by investing at regular intervals.

Note: Mutual Fund investing involves risk. Your Principal amount and investment return in a mutual fund will fluctuate in value. Your investment, when redeemed, may be worth more or less than the original cost.
Tax Consequences: Not all investment returns are subject to the same taxation. Short term and long term returns are taxed at different capital gains rates or even taxed as business income. The taxation policy should be kept in mind while deciding which investments to make.

Rupee Cost Averaging: Rupee cost averaging, the practice of committing a fixed amount of money to an investment program on a regular basis, is a popular practice with many long-term investors. By investing a set amount regularly (usually monthly or quarterly), investors are able to avoid the pitfalls of trying to time market peaks and valleys. Also, because the amount of the investments is set, investors who practice rupee cost averaging buy more shares of a stock or mutual fund when they are less costly and fewer shares when they are more expensive.
Like any investment strategy, rupee cost averaging doesn't guarantee a profit or protect against loss in a declining market. Because rupee cost averaging requires continuous investment regardless of fluctuating prices, you should consider your financial and emotional ability to continue the program through both rising and declining markets.

Q. How easy is it to make money from investment in shares?
Ans. It is not very easy to make consistent money from investing in the shares as there are lots of risks and uncertainties involved in that. That is why it is very important to pick the right stock at a right time matching your investment objective. Generally if you are buying shares of the company with a strong track record and good Management will always give decent return in the longer run. As already mentioned one should exercise due care and diligence in selecting particular stock.
One can also make money by trading into stocks and derivates. However, here again most stringent trading and money Management skill is required. For those who have articulated art of trading and investment investing in shares is very rewarding.

Q. How to analyze Stocks for investment and trading?
Ans. Broadly there is 2 methods to analyze stock
(i) Fundamental analysis and
(ii) Technical analysis

Generally for taking an investment decision of medium to long term horizon, fundamental analysis is widely followed. While for short term trading decisions Technical analysis is widely followed.

Fundamental Analysis involves evaluating companies value by evaluating companies business model, demand and supply of its product, its relative strengths and weakness in the industry in which it operates., the position of the industry, the sales and profit growth, return on equity, growth in earnings per share etc., value so arrived at is then compared with the on going market prices. If it is found that the market price is significantly lower than that, then it is advisable to buy the shares of that Company expecting that market will revalue the shares in future thereby offering capital appreciation in the value of the shares.

Technical Analysis on the other hand focuses on the market price movement of the share in the past mainly through graphs or price and traded volumes in order to judge further performance. Short term traders generally looking for a trading opportunity tries to capture the price trend for short term money making opportunities.
Although these two are widely followed and more rational approach for buying and selling decisions they are not infallible and hence are not full proof.

Q. What are the dos and don’ts that one should follow while investing into equities?

Ans. (i)Do not buy on rumors, debts. Remember investing in equity is not like a gambling, it involves skill and knowledge.

(ii)Always buy shares of companies whose business you understand. Consider investing in that stocks/industry with which you had an opportunity to work or may is a company manufacturing a popular product which you yourself use.

(iii)Study company thoroughly with whatever available information. Talk to people to whom you can trust to give you unbiased information about the company, read newspapers/ magazines to find leaders in various businesses.

(iv)For relative safety and better chances of appreciation buy shares for longer term, buy the shares as if you are buying business.

(v) Never buy in haste. If you are buying a good business for a longer term it is good buy irrespective of time.

(vi)Always diversify in 8 to 12 stocks since these are number of companies one can track regularly with proper focus. Too less a diversification makes a portfolio more risky at the same time too much of a diversification results in to loss of focus.

(vii) Never be impatient and panic. A short term ups and downs in the share prices resulting into paper profit or loss should not bother you much.

(viii) A good company with a good business and Management will always remain good investment in long term.

(ix) Do not buy the shares from borrowed capital. Borrowed money involves paying regular interest and returning capital at a predefined time since investment in the shares involves risks and requires patience of a long term nature, the time horizon and cost involved of the borrowed money some time may not match with the investment period.

Q. When the stocks should be sold for maximum profit?

Ans. There is nothing called right time to sell. Ideally one should sell the stock when the company stops posting growth, one can also sell when desired profit percentage is achieved. However, one should be realistic in his desire. It is widely believed that booking profit regularly is best way to maximize profits.

Q. What are the follow-up steps that one should take after investing in Shares?

Ans. It is necessary to review your financial position regularly, at least once a fortnight. Re-evaluate your portfolio to find whether you are making the best of the money you save and invest? Are you happy that you are getting the best possible return from them? Do they fit in with your current "risk profile" - should you, if you are getting closer to retirement, be thinking about reducing the level of risk in your portfolio of investments or should you actually be thinking about taking a few more risks if you have plenty of time in which to build up an investment?

Are your short-term investment giving you the desired rate of return or are you trapped by buying the stock at its peak? Book losses on these shares and try to invest in shares where you can make up for the losses.

In case of long term investment, track news on the stocks regularly. If there is a change in business environment, management or future profitability, the valuation of stocks will change accordingly, and hence the target price will also change.

Q. Where can my complaints relating to equity investments get redressed?

Ans. Following are the addresses of the authorities where any complaints against companies or market intermediaries can be sent:

Securities and Exchange Board of India (SEBI)

Plot No.C4-A,'G' Block, Bandra Kurla Complex, Bandra(East), Mumbai 400051

Tel : +91-22-26449000 / 40459000 Fax : +91-22-26449016-20 / 40459016-20

Besides the exchanges also have their own Grievance Cell to attend to investor complaints of companies / Brokers listed on their exchange.