Business Standard

Don't get swayed by events

Understand how an event will impact the companies that you are invested in or want to invest in

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Across the world, markets react to events often in an extreme manner. The sentiment prevalent in the markets sees wild swings in anticipation of the result of an impending event. Currently, due to the elections in India there is hope that a stable government will change things and the equity markets will be revived. The markets have already run up quite a bit riding on this hope factor.

Elections are indeed a huge event that can have significant effect on the way the economy of a country develops. In the interim there are many other events like the Reserve Bank of India's monetary policy, Index of Industrial Production figures, unemployment data from the US, reports from China, etc that affect market sentiment. As an investor, events like these cannot leave you untouched. There will be turmoil created in the minds of most investors and anxiety about their portfolios which might show sudden movements one way or the other depending on the mood of the market.

Many portfolios are showing very healthy returns due to the recent uptrend in the equity markets. But some people are very sceptical about these returns and are not fully convinced that equity as an asset class can deliver good returns. They are of the view that this is just a temporary phase and the returns will fall again if the markets fall. That is indeed true, as volatility is the nature of equity markets.

BEFORE RE-BALANCING YOUR PORTFOLIO

- Neither bull market nor bear market lasts forever
- Markets discount events that will impact investments in advance
- Do not enter or exit from the market based on events and their results
- Act only if the event will affect the performance of the businesses you are investing in
- Stick to your own financial plan which has defined goals and asset allocations

There are other people who have been sitting on the fence for some time bemoaning the flattish record of equity investments in the past few years. The changing scenario is making them question whether they should enter the markets now. They will still keep on thinking till the markets reach a new high, or will secretly be very happy about staying out if the markets crash again.

There is another set of people who continue to wait till the result of the event to decide on their own course of action. In the bargain most of them forget that they are losing something because they can never get back again-time. Time in the market is more important than timing the market.

Building your portfolio

Whenever there are events that will impact investments, investors need to understand that most of the expected repercussions are already discounted by markets. That is why markets are said to be efficient. As an ordinary investor one reads in the media what is already known and assimilated by the market. So you should not build or make decisions on your portfolio based on event-related news. Rather than trying to time your entry or exit from the market based on events and their results, it makes sense to try and understand how it might impact the companies or businesses that you are invested in or are going to invest in. If the scenario changes due to some event and is going to make fundamental changes in the way you foresee the performance of the businesses that you are investing in, only then does it call for action.

It is also necessary to keep in mind that businesses also protect themselves in various ways anticipating such events and changes. So, if the precautionary steps have already been taken, moats have already been built, there might be little reason for you as an investor to be worried.

How the markets behave is beyond the control of any individual or institution. But what is in the control of the investor is his own discipline. Being disciplined in sticking to your own financial plan which has defined goals and asset allocations will help you stay calm and composed in the chaos. If you have built a portfolio for your child's education which will be required after 10 years, these event-based fluctuations should not bother you. Of course it is a given that you need to select good investment candidates in the first place. Picking up duds and then expecting them to deliver will not help.

Remember that more money is made if one invests in bad times rather than in good times. If you continuously stick to your discipline of investing when the markets are low, the good times will reward your discipline by showing your returns. Investing in a market when it has already run up will show you mediocre results at best.

Recency bias

In behavioural science there is something defined as recency bias. It says that we tend to base our decisions on our recent experiences. During the bull run of 2005-2008, people kept flocking into the equity market. All sorts of companies were raising money through IPOs at heavy premiums and people felt that it was only a one-way ride up. Their enthusiasm to be a part of the bull run was based on their recent experience of seeing the market rise. They had forgotten the lessons learnt during the technology bubble burst.

The other side of the story played out post 2008. There was mayhem and nobody wanted to touch equity. There was a constant fear of the markets falling further and eroding the portfolio values forever. This fear not only prevented people from investing, it made them pull out money even at a loss. Investors who stuck to their asset allocations are winners today. Their portfolios are showing handsome returns. In fact, the positive returns are showing for investors who continued to systematically invest during the turbulent period too, and did not lose faith in their asset allocations and equity as an asset class.

When in a bull market we think it will last forever. When in a bear market we think it will never recover. We are on the upswing again and the same cycle is likely to play out if the markets keep on rising from here on. So investors need to be careful and be in touch with their personal financial plans or they might get easily swayed and react to events.

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