THE ECONOMIC TIMES By Sanket Dhanorkar, ET Bureau | 29 Sep, 2014

Missed the stock rally? Here's how you can still rake in profits

Once every year in the Brazilian capital of Rio de Janeiro, almost the entire nation stops and participates in the feverish merrymaking of the carnival. Nobody wants to miss out on the fun. Over the past year, the Indian stock market has also been witness to a carnival of sorts.

Equity investors bid goodbye to a bruising six-year-long volatile market as the sentiment turned decidedly bullish.

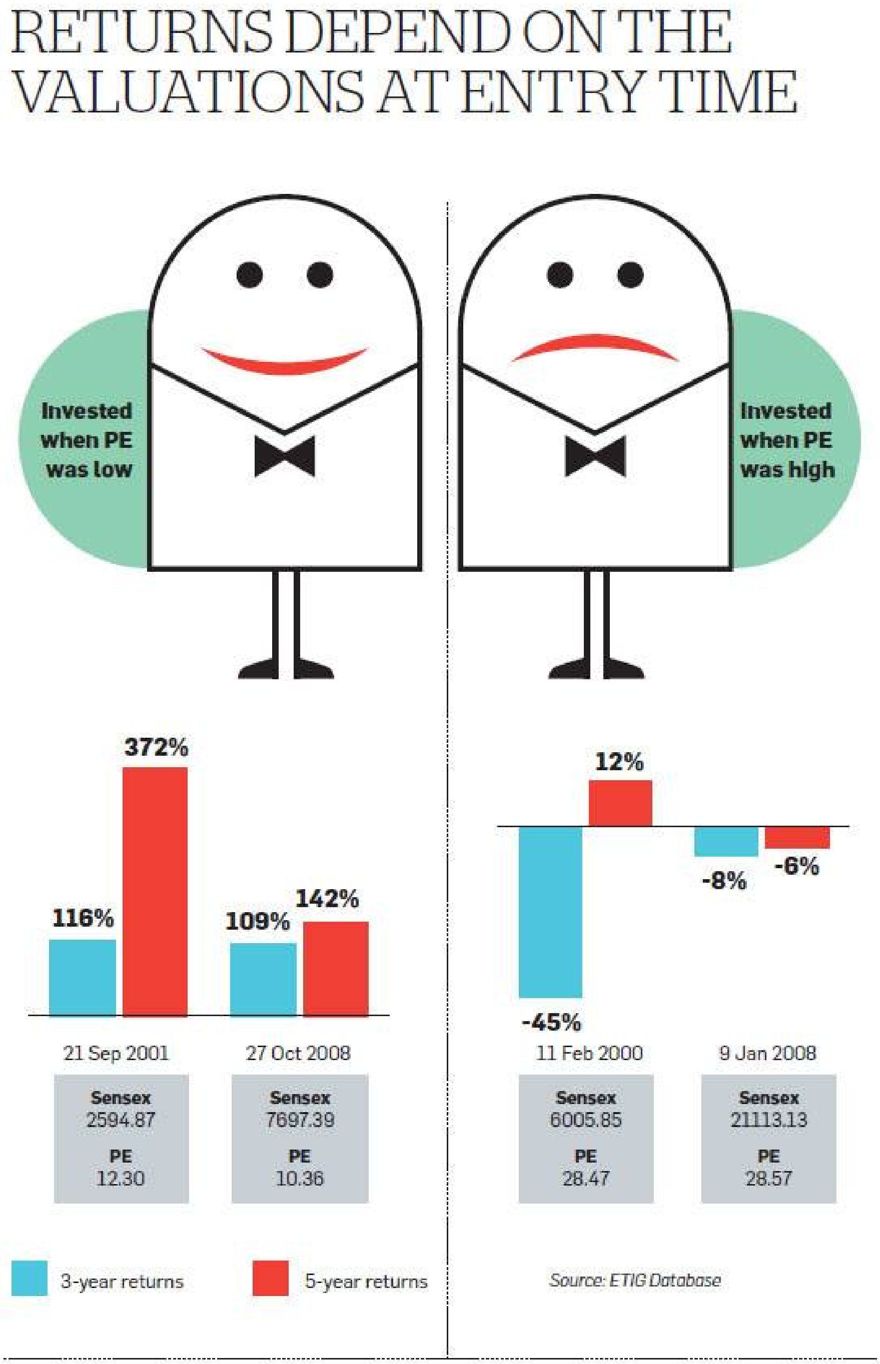
However, the similarity between the two carnivals ends here. A large part of the public here completely stayed away from the 'festivities' and only a handful of individuals really benefited from the rally. Most small investors remained on the sidelines, either afraid to venture into the stock market due to their previous bad experience, or unconvinced about the revival story, or both.

If you are among such investors, you are likely to be in a bind now. You can see the rewards that patient investors are reaping and want to get a piece of the pie. However, if you are trying to catch the bus, be aware of what you are getting into. The previous bull markets have shown enough instances of people ending up taking rash decisions as they tried to make up for lost opportunities. In the pages that follow, we lay out a path for all those who have been left behind by the charging bulls.

Should you jump in now?

If you have stayed away from the market all this time, do not be hard on yourself. The extent of the rally has caught even some seasoned market professionals by surprise.

Stocks prices have soared across the board, with some stocks doubling or even tripling in value. The big question is whether the bull market is likely to continue or is a correction waiting to happen? The consensus is that the Indian economy, after a long and exhausting ordeal, is well-placed to clock higher growth in the years to come. A confluence of various positives is expected to provide a big fillip to economic growth and corporate earnings. Nandkumar Surti, CEO, JP Morgan Asset Management Company, says that a combination of factors indicates that corporate profitability should steadily improve over the coming quarters. There is a strong leadership at the RBI and the Centre, proactive steps are being taken by the government to tackle inflation and crude oil prices are low, which augur well for the fiscal and current account deficit. "The equity market indices are a slave of corporate earning numbers and as long as the economic conditions continue to improve, the markets should continue with the positive trend in line with the earnings momentum," adds Surti.

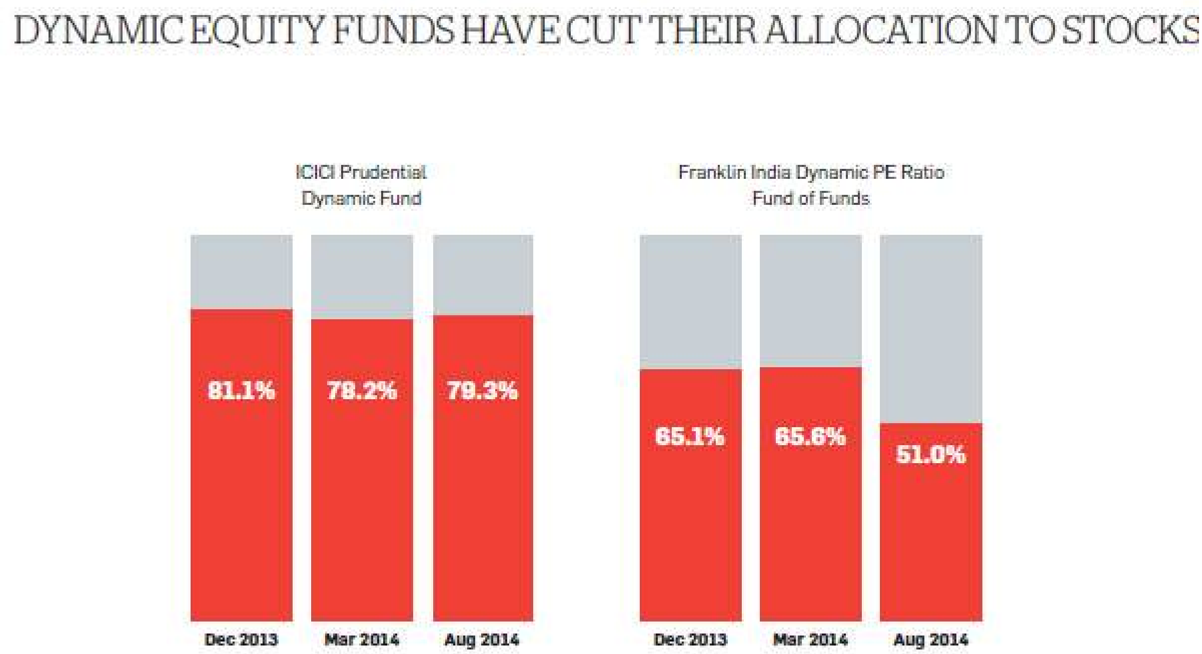


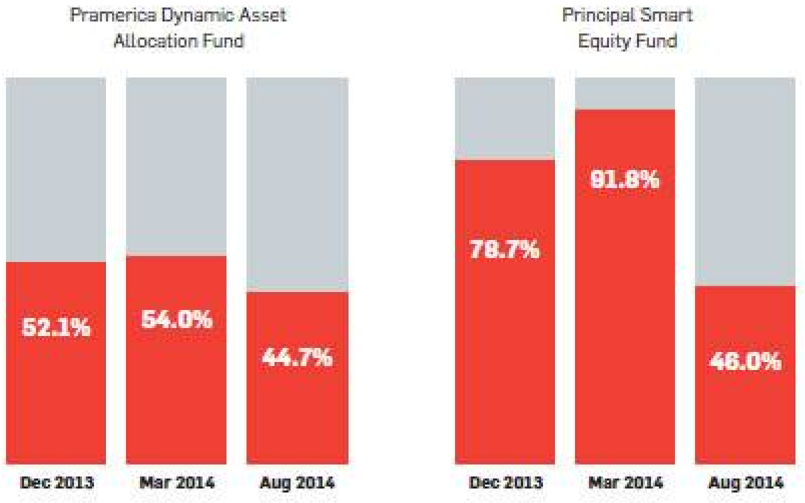
THE ECONOMIC TIMES By Sanket Dhanorkar, ET Bureau | 29 Sep, 2014

In a big endorsement of India's growth prospects under a new pro-reform government, global credit rating agency S&P revised India's credit outlook last week from 'negative' to 'stable'. This will further boost investor sentiment and attract a higher foreign flow into the domestic market.

The good news for investors is that most experts are convinced there is still a lot of steam left in the market. Even if you missed the initial rally, there is scope to make gains now. At 27,000, the Sensex may look lofty enough to deter investors from putting in money at these levels. This is where investors are getting the math completely wrong, says Vikas Gupta, executive vice-president, Arthveda Fund Management. Gupta argues that investors should not look at absolute index levels. "Though the market is at an alltime high in terms of absolute levels, such levels are hardly a measure of the true price of the markets."

Indeed, if you look at metrics such as price to earnings (PE) ratio and price to book value (PBV) ratio, the valuations are still below historic levels. This suggests that there is still scope for more gains. When the Sensex hit its previous peak in 2008, it was trading at 28 times its past 12 months' earnings. During the 2010 peak, it was at 24 times. By comparison, at the peak of 27,355 earlier this month, the Sensex PE was 19 (see graph).





Figures are % equity exposure of the fund; Data as on 31 Aug 2014. *Source: Value Research*

Experts say that those wanting to invest in stocks must step in now. Waiting for a correction to get a foot-hold in the market would not be a good idea. Nirakar Pradhan, CIO, Future Generali Life Insurance, says, "More money is lost in the stock market by waiting for correction than in actual correction. Rather than waiting for a correction, one should enter the market and follow a structured approach to investing in equity now." So if you are keen on putting in some money now, go ahead and do it. However, do not step into the market blindly. Make sure you have a proper strategy in place as you look to ride the unfolding recovery.

5 THINGS INVESTORS SHOULD DO NOW

1. Don't be in a hurry to build your equity allocation.

Having missed the rally and given the promise of gains still to be made, many investors would be tempted to dive headlong into the market now. They may try to ramp up their equity exposure in order to make up for the lost time. But diving into the deep end of the pool will not be a good idea, feel experts.

"Rushing in is never prudent in any situation, especially so in the stock markets," warns Lalit Nambiar, senior vice-president and fund manager (equities), and head of research, UTI Mutual Fund. The first thing any adviser will tell you is to stick to your chosen asset allocation. If you ignored that call during the downturn and chose to remain underinvested in equities, going overboard now will only compound the mistake. The biggest investing mistakes are made when the markets are at a high. Instead of investing in a hurry, it would be prudent to take a calibrated approach as you rebuild your presence in this asset class. Most importantly, don't invest with the expectation of quick gains. If you expect the stock market to repeat the performance of the past 12 months, you might be disappointed. A much longer investment time frame is required now. Keep in mind that the market is not trading cheap. Also, even though the economy is expected to kick into a higher gear, it is not likely to be a quick and sharp transition. There are several pieces of the jigsaw that are yet to fall into place. It may take a while before the economy fully regains its vibrancy. It will not be a smooth ride for the markets. Returns may come in spurts and may take longer to materialise.

SIP RETURNS TURNED THE CORNER IN 2014

Investors who lost patience and stopped SIPs in 2013 missed out on the gains in 2014.

		SIP RETURNS IN AUG 2013 (%)			SIP RETURNS IN AUG 2014 (%)		
SCHEME	AUM (₹ CR)	1-YEAR	3-YEAR	5-YEAR	1-YEAR	3-YEAR	5-YEAR
HDFC Equity Fund	15,812.55	-21.87	-6.66	4.99	81.00	32.22	19.89
HDFC Top 200 Fund	12,979.38	-18.79	-4.55	5.03	68.16	28.67	18.03
Reliance Equity Opportunities Fund Fund - Regular Plan	8,105.34	-18.20	-0.13	11.52	70.46	31.41	22.00
ICICI Prudential Focused Bluechip Equity	7,274.38	-4.07	3.32	10.83	54.46	27.47	18.96
HDFC Mid-Cap Opportunities Fund	6,861.74	-19.03	-1.78	10.05	94.90	39.25	26.60

Data as on 28 Aug of both years. *Source: Value Research*

Also, while building the equity portfolio, investors should refrain from chasing the outperformers of the year. For instance, the rally so far has been much more pronounced in the mid- and small-cap space. Many of these stocks have grown 2-3 times in value barely over a year. These returns are surely tempting, but do not expect the same level of performance going ahead, simply because many of these businesses are yet to show an improvement in earnings. It would be better to focus on companies that exhibit quality in earnings. These would mostly be in the large-cap space, where strong balance sheets combine with quality management. Gupta asserts, "Avoid going in for the fancy stocks which can succumb under pressure. Opt for ultra large-caps such as the Nifty-based stocks, where the downside risk is lesser. One would much rather go wrong with a Nestle rather than a DLF."

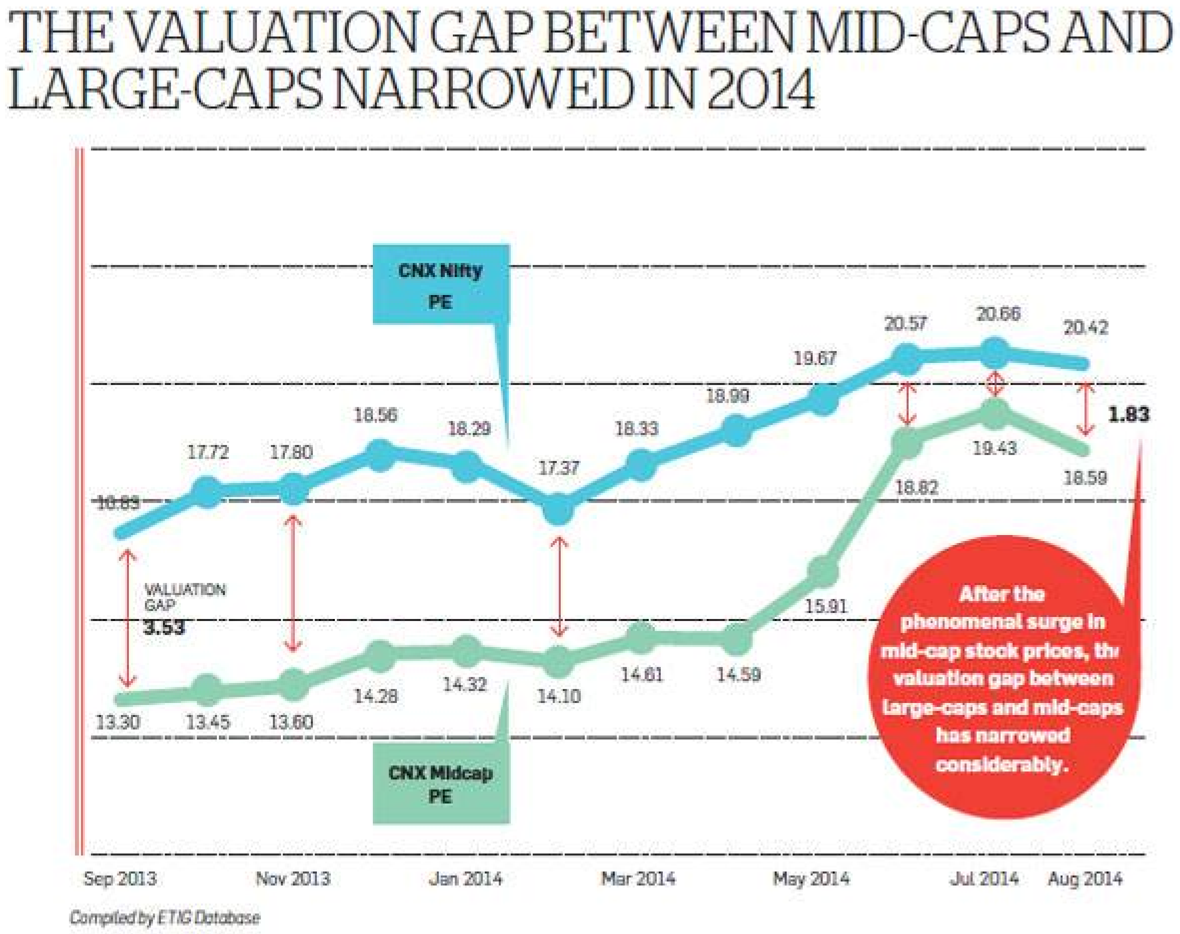
Lastly, even as you look to ramp up your equity allocation, do not ignore other investment classes. When the stock market is galloping, it is easy to forget other asset classes. Don't shift your money from debt investments to the equity market. Neeraj Chauhan, CEO, Financial Mall, says, "Maintain your asset allocation at all times. You may shore up your equity allocation, but not beyond what is required and certainly not at the cost of other asset classes."

2. Avoid picking stocks on your own

Until a few months ago, stocks across the board were shooting up due to the improved investor sentiment. Placing bets on individual stocks was an easier proposition. You could bet on any company that offered a play on the economic recovery and make tidy gains. Even low quality stocks had a good run. Feroze Azeez, executive director and head, investment products, Anand Rathi Private Wealth Management, says, "In the recent rise, there are a number of stocks that would have run ahead of their fundamentals. Investors generally give more weightage to past performance while picking stocks, instead of understanding the dynamics of the business and the industry in which they operate."

The picture has changed somewhat since then. There are gains still to be made, but picking stocks on your own will become increasingly difficult now. Investors must pay more heed to valuations. The margin of safety is narrower at current prices. Also, with markets shifting focus from one sector to another, bottom-up stock picking has become critical. Simply identifying good sectors and picking the best company among the lot will not yield the best results. You will have to dig deeper and assess individual companies on their merits given that there is a dearth of quality in earnings. Nambiar argues, "The market has passed the stage where buying anything and everything would have given you smart returns. It is now a stock-picker's market."

Small investors would do well to get a seasoned professional to pick stocks for them. A fund manager is adept at picking stocks in different market situations. This is evident from the performance of equity funds in the past year. While the benchmark Nifty index has gained 29.2% over the past year, the large-cap funds that invest in stocks from this universe have fetched 31.4% on an average. Compared to the 33.8% gains seen in the broader BSE-500 index, mid- and small-cap funds have averaged 37.6%. Surely, most fund managers are doing their job well. Also, since equity funds invest across a range of stocks and sectors, it reduces much of the risk of holding only a handful of stocks. While choosing the funds, however, make sure you invest in only those that have a consistent track record. Surti cautions people to invest in line with their risk appetite. "Firsttime investors should start with funds that invest in blue chips. They can gradually look up the risk curve in terms of mid- and smallcap funds," he adds.



3. SIP is the right approach, but...

Even when you take the mutual fund route, don't invest a large sum at one go. Build your equity exposure gradually, using systematic investment plans (SIPs). It is a time-tested approach to investing. When the stock market was facing a lot of turmoil and uncertainty last year, advisers were trying to get clients to stick to their SIP investments irrespective of the prevailing market conditions. Unfortunately, many investors chose to terminate their long-running SIPs at that time, disillusioned by the low single-digit returns, or even losses in some cases. The handful of people who took the advice and continued with their monthly SIP contributions are sitting pretty today (see graphic). Take the example of ICICI Prudential Value Discovery Fund. Suppose you had started a monthly SIP in the fund from December 2010, and continued with the same, your investment would have fetched a staggering 18.75% return compounded yearly. But if you had discontinued your SIP in August last year and redeemed your funds, your investment would have yielded -1.2%. This clearly shows the magic that this simple investing technique can work on your money if you give it enough time. The SIP approach is appealing even today, as it works in most market situations.

There is no right time to start an SIP. However, if you are starting out today, you may have to take a slightly different approach. Azeez says that newcomers may have to bite the bullet and invest some money as a lump sum. "If one is underweight in equities and needs to increase his allocation, we would favour a lump-sum investment. In a secular bull market, investors do not benefit by investing through SIP rather than a lump sum." Start with a sum equal to 3-4 SIPs and then gradually add more every month. However, make sure to invest only the money you will not need for the next 3-5 years. As Surti says, "If investors come in with a 3-5 year perspective, the chances of disappointment are very low."

4. Opt for dynamic asset allocation funds

If you are keen to take equity exposure now but aren't sure how much you should invest, a dynamic asset allocation fund could be the right option for you. Dynamic funds continuously change their allocation to equities depending on the market conditions. The fund manager shifts between equity and debt based on their attractiveness as indicated by certain valuation metrics. Most of these funds rely on simple valuation metrics to arrive at the optimum allocation. Schemes like the Principal Smart Fund and Franklin Templeton Dynamic PE Fund take exposure to equities based on the price to earnings ratio (PE) of the Nifty Index. The Franklin Templeton Dynamic PE Fund, for instance, determines the allocation to its equity fund on the basis of the month-end weighted average PE ratio of the S&P CNX Nifty Index, and the balance is invested in its income fund. The scheme increases the allocation to the Franklin India Bluechip Fund (which invests in equities) when the Nifty PE falls to capitalise on the upside potential, and reduces the allocation when the Nifty PE is high, to limit the downside risk. Currently, for instance, most dynamic funds are tilted heavily towards debt and cash, having brought down the exposure to equities steadily as the markets climbed higher levels (see graphic).

THE ECONOMIC TIMES By Sanket Dhanorkar, ET Bureau | 29 Sep, 2014

MANY MID-CAPS HAVE ZOOMED

Valuations of many mid-cap stocks are at record highs after this year's rally.

	STOCK PRICE (₹)	2014 RETURNS (%)	PE
Century Textiles	551.70	128.83	162.74
ABB India	1,203.15	121.21	130.07
Jain Irrigation Systems	88.05	52.07	100.06
Siemens	880.60	84.21	99.39
Just Dial	1,639.55	93.63	95.32
Ashok Leyland	38.95	158.93	90.58
Ramco Cements	325.10	82.90	73.55
Eicher Motors	11,636.50	228.37	63.04
Max India	351.50	84.08	56.69
Crompton Greaves	207.45	140.66	52.52

Data as on 24 Sept 2014. *Source: ETIG Database*

By investing in such a fund, you will not have to take the tough call on how much to invest at what time. The automatic reallocation model followed by the fund will take emotions out of investing decisions. However, keep in mind the taxation angle for these funds. Since most dynamic funds are perennially in transition moving in and out of debt and equities, the taxation on returns is also bound to vary. Hence, at the time of exiting such a scheme, if it has maintained, on an average, 65% of its corpus in equities for that particular year, the scheme is treated as an equity fund for taxation purposes. Otherwise, the investment is treated as a non-equity fund, attracting tax even on long-term gains.

5. Do not get comfortable with closed-ended funds

Even as the markets have taken off since last year, there has been an explosion of closedended equity schemes from fund houses. Sensing an opportunity to ride investor sentiment and gather money, mutual funds are churning out these products at a furious pace. Those who have invested in these funds have no reason to complain; this mutual fund category has yielded superb returns during this period. But investors need to understand that these funds come with a much different product proposition. Unlike traditional open-ended funds, which allow you to invest and redeem money at any point of time, closed-ended funds allow only one point of entry and exit. They come with a fixed tenure, typically 3-5 years, after which you get back the money at the NAV prevailing at that time. This enhances the risk profile of the fund beyond that carried by traditional open-ended equity funds.

In the absence of a SIP facility in these funds, you are forced to lock in the entire capital at one price point. The entry price then becomes critical to the return you ultimately get. There is a possibility of investing at a level which is close to or at the peak value Closed-ended equity funds launched last year have done so well thus far primarily because they invested at a time when valuations were at significant lows. The single point of exit also poses a problem as no matter how high the market flies in the interim, if the market tanks towards the end of your fund's tenure, you will take a hit. Unlike an open-ended fund, you will not be able to book profit in the interim. There is no certainty that the currently high-flying closeended funds will yield a high return come maturity. Besides, the lack of a track record makes it difficult to identify better funds. That is why experts suggest that investors stay away from closed-ended offerings as far as possible. There are enough open-ended funds that investors can tap into to satiate their equity appetite.