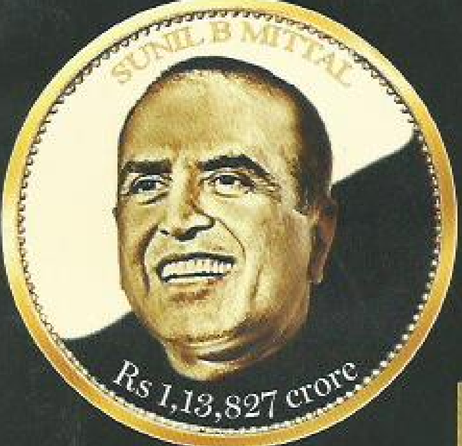
SPECIAL ISSUE

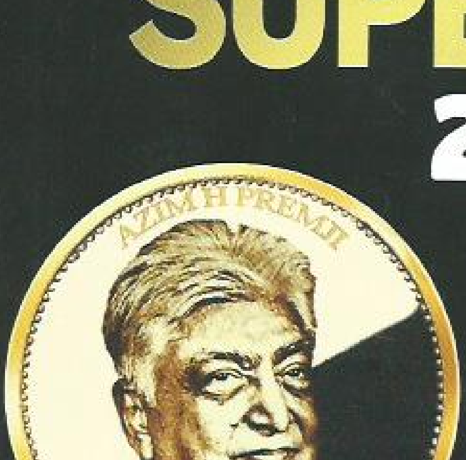
BW | BUSINESSWORLD

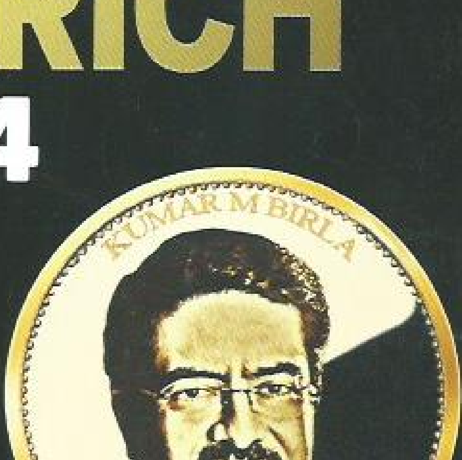
www.businessworld.in

RNI NO. 39847/81 | 14 JULY 2014

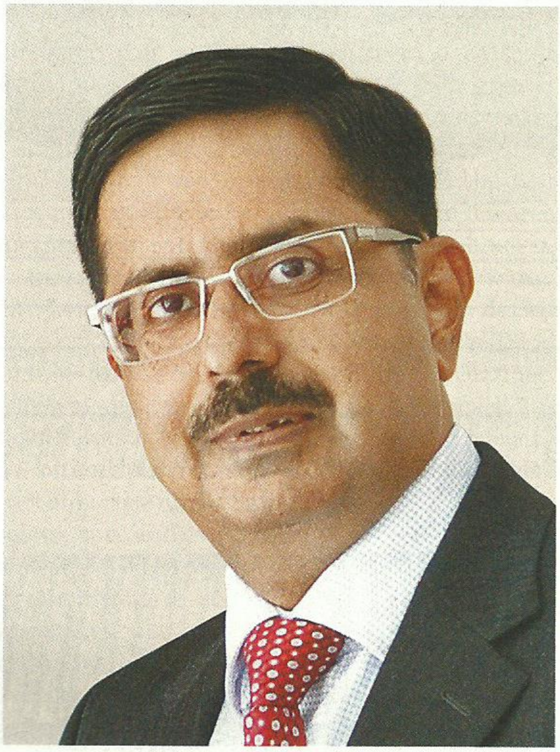


INDIA'S SUPER RICH 2014





ISSN 0970819-7



By Pankaj Chopra

WHEN PATIENCE IS A VIRTUE

Equities, more than any other asset class, offer the best returns, provided they are long-term investments

WHEN ONE THINKS ABOUT LONG-TERM INVESTMENT IN equities, the first thing that comes to mind is what Warren Buffett once said: "Someone is sitting in the shade today because someone planted a tree long time ago."

The stock market is just like a vegetable or fish market, where people come together to buy or sell. It is really up to you to decide what you are doing in the stock market. Are you a day trader, a speculator, a short-term or a long-term investor? The problem is that people often enter the markets with no clear idea; normally, when the markets are doing well, in an attempt to make a quick and easy buck. But mistiming this entry eventually leads to losses, and such people end up having no option besides becoming long-term investors. As Adam Smith famously said, "If you don't know who you are, the stock market is an expensive place to find out."

A look at the history of the BSE Sensex, the first index that was set up to monitor the Indian markets, and one of the most popular ones till date, shows that its journey from 1979 to 2014 has been very fascinating. With all its booms and busts over the years, the Sensex has moved from an initial value of 100 to the current 25,000 points, up 250 times in 35 years!

People often ask why it is that equities provide the best long-term returns. The answer is quite simple. An analysis of any other investment avenue, including gold, real estate and debt, shows that these are static options. By this, I mean that these assets do not grow in size, even if they are kept for decades. Only their value goes up or down based on the demand and supply changes. In contrast, equities represent a share of the business, and if one invests in growing businesses, the earnings growth from these com-

Photograph by Umesh Goswami

panies makes sure that the underlying company itself is becoming more valuable by the day. Again, as Buffett aptly put it: "When we own portions of outstanding businesses with outstanding managements, our favourite holding period is forever."

The key, then, is to be able to understand businesses and have patience. Unfortunately, both these traits are quite rare in the markets. When it is difficult to devote time for researching companies, most people focus on the next best thing — price. Large swathes of so-called investors are actually just playing on the price. A quote by Oscar Wilde fits this situation beautifully: "Nowadays, everyone knows the price of everything, but the value of nothing."

How many times have you heard someone say something like "the price of this stock has doubled in six months"? While it's an attempt to sound intelligent and informed, this sentence conveys absolutely no information about what may happen to the stock from now on and, therefore, has no value. Again, as Buffett says, "If past history was all there was to the game, the richest people would be librarians."

Returning to our example of the shade of a large tree, if you are going to keep chopping off anything that grows six inches above the ground because you can't keep still (have patience), why bother putting in the seed of a tree? Or, maybe, you just don't know the potential of your investments. While you sit back and watch the beauty of a freshly mowed lawn, maybe you've just killed a few oak saplings that could have provided shade to the entire neighbourhood in a few years.

But what defines a long-term investment and what should be the investment horizon? There is no 'one-size-fits-all' answer to this question. People give various answers, mostly in the range of three to five years. It's also often said that as one grows older, the investment horizon diminishes. I don't agree with this and believe that allocation to equities should be retained for as long as there is no requirement for the money or a better investment alternative emerges. In fact, I feel that equities should be an integral part of multi-generational portfolios that are handed down to the next generation, as the true power of compounding will be seen in later years.

This is not to say that one should just put money in equities and forget about it. On the contrary, it is important to monitor individual investments in shares of companies, to make sure the portfolio is current and suitably reflects the opportunities of the present time. After all, the index is just representative of the top few stocks. Markets abound with attractive deals for the bargain hunter. This is where either detailed and continuous research on one's own or entrusting investments to a trusted money manager is imperative. The other aspect of investment in equities is timing. Even if I am looking to invest for the long term, should I invest now or when the markets fall? This is the dilemma.

Equities should be an integral part of multi-generational portfolios that are handed down to next generation, as the true power of compounding will be seen in later years

Short-term movements in the markets are a result of hundreds of factors, unknown in advance. Trying to predict market movements by looking at the current prices are like reading today's newspaper over and over again, in an attempt to predict tomorrow's news.

As they say, "time in the market is better than timing the markets". As long as you haven't mistimed the markets completely, it's just a matter of time before the growth of the companies you invest in ensures that you start getting attractive returns on your investments. It is crucial to remain patient, and keep a close watch on the companies in your portfolio.

The markets have rallied recently, in expectation of, and following, the formation of a strong government. The biggest question on investors' minds is: Has it gone up too much and too fast? While predicting short-term movements in the markets is futile, one can see that the last time the BSE Sensex touched 21,000 points in early 2008, the earnings of companies were much lower than they are six years later, in 2014. Thus, while the markets may have rebounded and crossed earlier highs, the earnings are currently much more supportive and, thus, valuations are cheaper relative to 2008. BW

The author is founder and chief executive officer of Five Rivers Portfolio Managers