Market Euphoria and Herd Mentality are Lethal Weapons

Background

In August'2021, the Indian Stock Market made new highs; the Nifty 50 index breached the level of 17,150, and Sensex index also breached the level of 57,600, and was about to go higher. The liquidity was high, FIIs and DII's were net buyers, and the Covid cases were not rising. The market was touching new highs.

Challenge

Few Clients connected with us to invest in the stock market with fresh capital.

Further, some retired individuals whose only income was pension and income from regular income earning sources wanted to invest their emergency monies, and money from FDs into the stock market. Investing one's retirement savings in the stock market is definitely not the right thing to do. Furthermore, they were following the herd mentality of their friends and were investing when markets were only going up.

Solution

Being fearful when others are greedy has a lot of weight in Warren Buffet's anecdote. We advise our clients based on the time horizon, goals, and investment objectives. We advised them not to use their emergency funds or any other funds that are linked to short-term goals (1-3 years) or their retirement monies. Also, we suggested it is best to invest in the dips in a phased manner so that the rupee cost averaging happens in case of sudden Volatility. Risk management, Diversification, and proper Monitoring of the stocks is the key here.

<u>EXAMPLE & ANALYSES:</u>

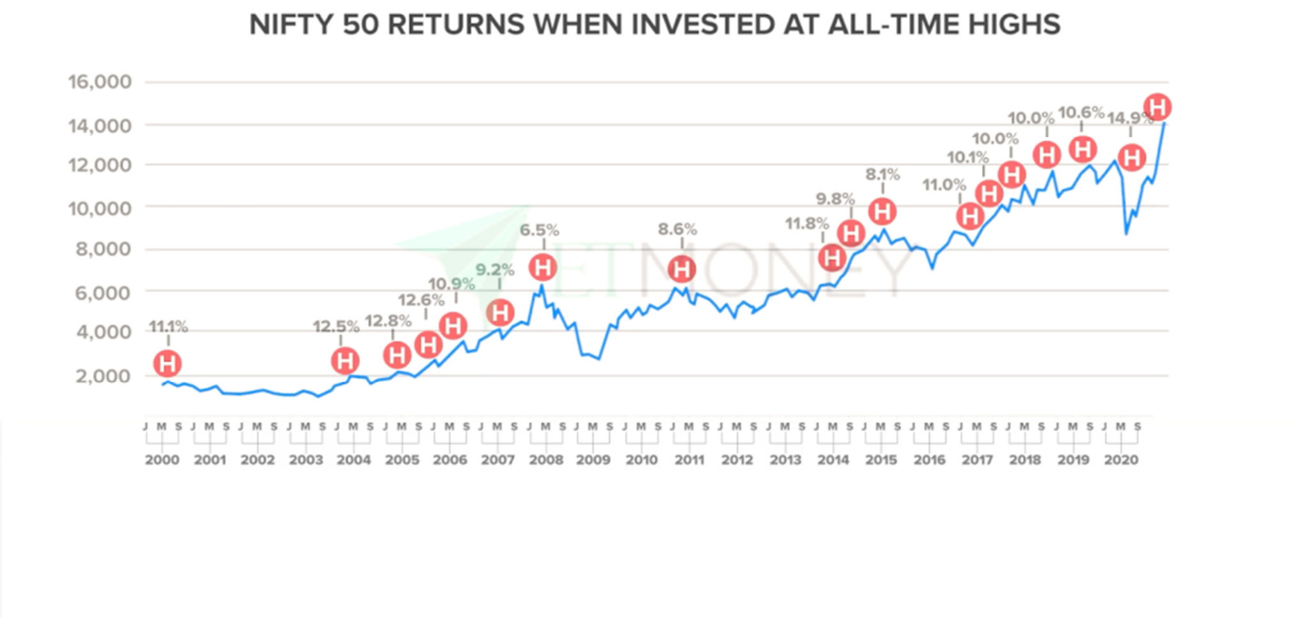
SNIPPET FROM ET MONEY

"Timing the Market vs Time in the Market: What's the better approach?" published Mar 21st 2023

To understand the importance of spending time in the markets rather than timing the market, let us examine what would have happened had you made the ultimate mistake i.e. invest money only when the stock markets hit a new all-time high.

Assume you invested some money in January of 2000, when the NIFTY touched an all-time high of 1,546 points. Since then the NIFTY has climbed quite a bit and was at 13,981 on 31st December 2020, which comes to a little over 9 times. 9 times in 21 years means an annualized return of 11.1%.

Similarly, let’s map the annualized returns when one invests at different all-time high months throughout the last 21 years. Say, you invested 10,000 rupees in each of the all-time high months in a simple NIFTY 50 Index Fund.



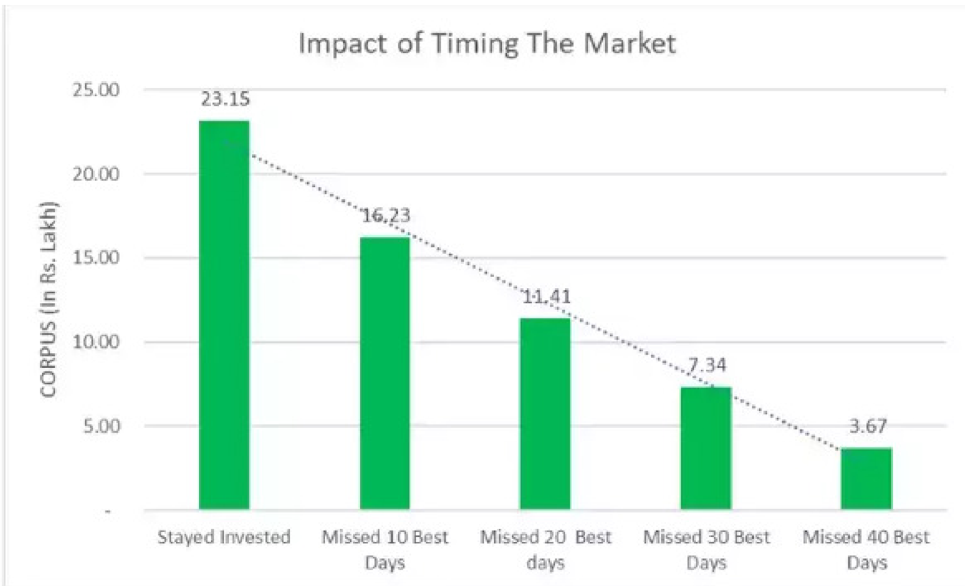
Since there have been 55 months when the NIFTY 50 Index had reached a lifetime high, you would have invested Rs. 5.5 lakh in those 21 years. Now, to keep it simple, let’s use the buy-and-hold strategy i.e. once you invested 10,000 rupees at these all-time high months, you would not sell these investments.

In that case, the Rs. 5.5 lakh of investments would have grown over the years and as of December 31, 2020, the total corpus would be at over Rs. 17.5 lakh. On an annualized basis, it comes to returns of 10.8%. This is actually quite respectable given the fact that your investments have done rather well in spite of your timing mistake.

But 10.8% does not include dividends received from the Nifty 50 companies. So after adding the dividends, the annualized returns go up even further and returns stand at 12.3% per annum in spite of having invested only in all-time high months. In other words, the fears of investing at all-time highs really did not materialize. This certainly shows that as an investor what you presently see as an all-time high can very well seem extremely low in the future.

- **Always stick to your asset allocation.** Asset allocation is crucial to good risk-adjusted long-term returns. There are studies after studies that have stressed the importance of balancing your portfolio across different assets like domestic equities, international equities, debt, fixed deposits, savings accounts, gold, and even physical assets like real estate.

- Do periodic rebalancing of your portfolio. Rebalancing is done to bring your portfolio back on track to your original asset allocation. This exercise ensures that your portfolio's risk is not lopsided and that you can manage drawdowns better.



The above is based on returns by NIFTY|50 TRI

Clearly, spending time in the market can help you accumulate a bigger corpus as opposed to trying to time the market.

Conclusion

Spending time in the market may sound boring, but it is effective. If investors are able to give enough time to their investments, they will automatically improve their chances of earning good returns.

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