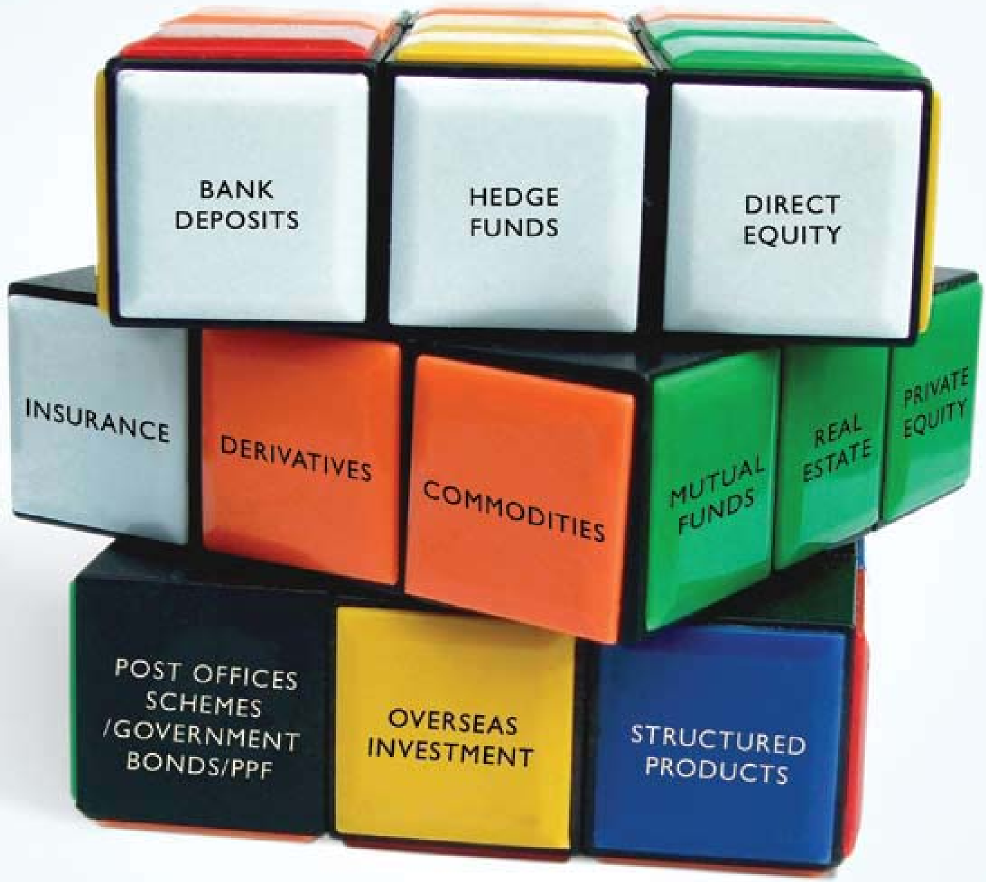

Investor psychology

in the maze of investment options

Has the investor matured enough to understand the many choices and offering which are available to him today and acting more rationally than earlier or has he become more confused and looking for answers & guidance.

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Volatility has become order of the day and if you have been tracking Equity markets for the last few months you will understand the point I am trying to make here. The kind of volatility we have witnessed in this asset class in recent times is unprecedented. It is true with other asset classes like Gold, Currencies, and Bonds etc also. This leaves the investor baffled at times. If we get into further details, we find that the continuous volatility is affecting Investor Psychology in a big way. We, therefore, have to get into an investor's mind and experience the upheavals going on there. We will now try to attempt and compare the investing experience across two different time periods. We will go back to early 80's and check the options available then and compare with the options available now and then see actually how it has affected the investor today. Has he matured enough to understand these choices completely and acting more rationally than earlier or he has become even more confused and looking for answers and guidance.

In earlier times Investor had the option of investing in plain vanilla Bank Deposits, Government Bonds, Post Office schemes like NSC, Indira Vikas Patra, Kisan Vikas Patra and Monthly Income Schemes. If he wanted exposure in real estate, he was buying land primarily. He bought gold mainly for his personal use on occasions like festival, marriage etc. and never seriously thought of it as an asset class.

In today's scenario we have to take into account a major change i.e. economic prosperity all over. The entire world is talking about the robust growth rates in this part of the world. Higher income levels and booming stock markets have led to more and more numbers of HNIs. This means the availability of huge investible surplus. The investors with higher risk appetite want to experiment and try new and exotic products in the name of diversification. This has resulted in emergence of new options within the same or fresh asset classes. There are more products available with in each asset class be it Equity, Mutual Fund, Gold, Real Estate etc. Let us examine the same in little more detail.

Bank Deposits

The plain vanilla Bank Deposit is easier to understand of all the products. There is not much change in this product over the years other than deregulation of interest rates. In the early 80's we had regulated interest rates on these deposits and there was huge interest in this asset class as there were fewer choices then. Now the interest rate is deregulated and that actually makes the choice easy but this also leaves in more risky situation at times when you get lured for higher interest rate only move your funds to towards a weak bank. The other changes in recent times are primarily technology related like we have flexi deposits and floating rate deposits.

Post Offices Schemes /Government Bonds/PPF

There is not much change in the product features in any of these products and the only change over the years is the reduction of interest rates from around 12% to 8% now. Around three years back when the rates on bank deposit started testing bottom and touched as low as 6%, all these small savings schemes got huge investments as there was an arbitrage opportunity to earn higher return and in few products like PPF, NSC you got tax benefits also. However at the moment bank FD rates are quoting slightly higher and except NSC and PPF other small savings schemes do not offer attractive returns.

Mutual Funds

This is an option which has shown mind-boggling growth and it has become one of the most important and popular choice in recent times. Under this option if we look at earlier era we had few MF schemes like MasterShare and Mastergain from Unit Trust of India, Morgan Stanley Growth Fund which generated huge response. Today, there are over 600 MF schemes available and there are at least 20 types of variants like Diversified, Sectoral, Floaters, Liquid, and Arbitrage etc. There were more than 150 New Fund Offers last year. Even for investment/disinvestments there are several ways known as Systematic Investment Plans (SIPs), Systematic Withdrawal Plans(SWP). The SIPs actually works on rupee cost averaging and then there is another concept called "Value Averaging" thus ultimately leaving investor wandering how to select the best option?

Direct Equity

One can invest in direct equity himself through a local broker or by utilizing the online platform of any large bank/NBFC. The other option is to avail the service of a reputed Broker/AMC and sign on the Portfolio Management Scheme (PMS) offered by them.

For Primary market investment, one can apply for Initial Public Offers of various corporate. In the earlier era also, I remember at times there used to be euphoria of IPOs. People used to apply regularly and make some money on listing day. This still continues for some investors and actually it has become quite easier now if you are a tech savvy investor. Sign

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on with any online platform of a bank/ NBFC and on the click of a button you can apply for IPO and need not worry about filling up forms or getting your refund orders back in time. Everything is instant now right from applying for new shares to getting back your refund in your bank account in less than a month's time.

To decide on PMS provider one has to be careful though as most of them will talk about capital preservation with quality growth. They will assure the investor about good model and research-based advice and obviously about consistent returns. One has to then see whether they have process driven methods of capturing periodic gains and their performance history during volatile periods. One has to look at the margin of safety and kind of churning in the portfolio and last but not the least the kind of fee model i.e. flat or hurdle approach and understand the risk. At the end our investor is again at the crossroad and struggling to take the decision.

DERIVATIVES CAN BE USED FOR Hedging, Speculating or Arbitrage. This is a double edged sword and if not used judiciously this can destroy the total net worth of an investor so when to use it and how to use it is a big question for the investor today.

Insurance

In the earlier days, Insurance was bought primarily for tax purposes and very few people actually bothered about life cover as such. LIC was the only player and offered money back policies, endowment policies and few single premium policies like Bima Nivesh. However, as an asset class it was not considered an option and there were not many schemes available for retirement planning. People were grossly underinsured and there were no private insurers. Nobody even talked about pure insurance cover or term insurance. Look at the options today, there are whole lot of private players and offer several choices. The schemes are packaged in such a way that investor look at it not only from tax saving's point of view but also as a retirement planning option. There are people who want to buy it only for life cover and would go for term insurance. ULIPs are hugely popular and sold as an attractive asset with Insurance/Retirement benefit. People are generally aware now about insurance cover, yet given the plethora of insurance products, making the right choice becomes difficult at times. Investor is left thinking what product to buy and from whom.

Overseas Investment

RBI has come out with one more option for Resident Indians today. One can invest upto 2 lakh US $ abroad in one name and minors are also included in this scheme. So if a family of four with husband, wife and two kids wants to invest abroad, they can buy real estate, stocks, derivatives, currency etc upto a total value of US $ 8 lacs. One can retain, reinvest and repatriate this asset. What you actually need here is a bank account with a branch, which allows foreign remittances, and an account with a provider of these overseas options. The provider can be a large bank or NBFC with an online platform for these options. This option primarily suits HNIs who would like to invest in global products. But the question to be answered here is do they fully understand the taxation methods, systems, procedures etc. The other risk may be that an asset like overseas Real estate investment is vulnerable to scam at times. The market depth is generally there so manipulation by single fund or investor is difficult but risks are inherent in all such investments and there are specific bars from RBI angle as you cannot buy lotteries or cannot send margin money on overseas exchanges etc.

Derivatives

Derivatives are primarily financial agreements derived from some underlying assets. These underlying has to be quantifiable and can be anything from Equity/Forex/Loan etc. Derivatives can be used for Hedging, Speculating or Arbitrage. This is a double edged sword and if not used judiciously this can destroy the total net worth of an investor so when to use it and how to use it is a big question for the investor today.

Commodities

Indian markets have recently thrown open a new avenue for investors in the form of Commodity derivatives. For those who want to diversify their portfolios beyond shares, bonds and real estate, commodities are another option available now. Commodities offer potential to become a separate asset class for market-savvy investors in times to come. This can be a hedging tool also if one has specific interest in a particular commodity. Investors who claim to understand the equity markets may find commodities an unfathomable market. With the setting up of three multi-commodity exchanges in the country, retail investors can now trade in commodity futures without having physical stocks. These exchanges are regulated by the Forward Markets Commission. Unlike the equity markets, brokers don't need to register themselves with the regulator. The FMC deals with exchange administration and will seek to inspect the books of brokers only if foul practices are suspected or if the exchanges themselves fail to take action. Now to invest in this asset class one has to go to a member broker. Several already-established equity brokers have sought membership with these exchanges. Some of them also offer trading through Internet just like the way they offer equities. You can also get a list of more members from the respective exchanges and decide upon the broker you want to choose from. At the end the investor is left with few questions again which commodity has to be bought and why. There is a global market for most of such commodities so it has lot of depth but the risks are also inherent in this form of investment.

Gold

In recent times gold has appreciated and every body is now talking about this new asset class and it is termed as a very good hedge also. More importantly, the dollar is weakening so globally and the hedge concept is actually better understood than ever before. In Indian Context, earlier people used to buy gold in form of jewellary on occasions like marriage, festival etc. On the investment front, few investors used to buy gold bars. Today you have more options and slightly better options to invest in Gold. More and more investors are buying Gold ETFs, as this is one of the best ways to invest in Gold. Another variant is investing in gold mines across the world. This option is also available through MF route as there are specific MF scheme investing in gold mining companies across the world.

Real Estate

The only way one could invest in this asset class earlier was to buy a piece of land or house/shop. However, the property market is not that efficient, not very transparent at times, the liquidity a major constraint and the transaction costs very high thus making the decision to invest very difficult. One has to look at the options then like reality funds. A reality fund is an entity established usually in the form of a trust or a company for collecting funds from various investors (known as contributors) which then invest these funds in portfolio companies engaged in developing real estate projects with the objective of realizing profits from such investments with in a defined time frame. These funds are typically structured as pooled vehicles into portfolio companies or special purpose vehicles (SPVs), which offers the contributors a number of benefits such as leveraging and tax efficiency. The portfolio companies generate cash flows in the term of periodical income and/or sales realization and generate returns largely through dividend and capital gains for the contributors.

One can also buy stocks of Real Estate companies being listed on exchanges. There is a possibility now for Real Estate Mutual Funds to be introduced soon. We come back to the same question and look for the best option out of those discussed

Art

In the recent times this asset class has established its return credentials and the market depth is increasing day by day. Auction around the year and around the globe is providing bit of liquidity regularly. There is insurance cover available and the logistics improving day by day. The artist history, work quality, medium and movement determine value of an art piece. Apart from insurance and storage, restoration infrastructure is improving the asset class credentials and investors are looking at long term prospective. It has become fashionable to invest in art these days. Art investment is through two routes it can be art advisory for art collectors whereas it can be art funds for the pure investor.

COMMODITIES OFFER POTENTIAL to become a separate asset class for market-savvy investors in times to come. This can be a hedging tool also if one has specific interest in a particular commodity.

Conclusion

So we can now surely conclude that there are options and with in those options there are more options. Investor looks at superior returns and measured risk. The point now is whether you have time, inclination or energy to get into those options, evaluate them or concentrate on your core competencies and focus all your energies there. Then you have to leave these Asset class selections to the people who actually excel in this job and provide you the best options suitable for you. One needs investing solutions that are customized to suit each client needs and risk appetite. Investor looks at dynamically balanced asset allocation mix consisting of above mentioned asset classes. There are Financial Planners in the market to help an Investor today. They help investors to plan budget, identify financial goals and suggest diversification keeping in the risk appetite of the investor. I personally feel that one has to enjoy his life and leave the rest to experts and more importantly trust them. If you can trust your personal physical trainer or your medical doctor by following their instructions then there are definitely huge benefits and mental peace if you follow your Financial Planner's advice the same way.

The investors with higher risk appetite want to experiment and try new and exotic products in the name of diversification. This has resulted in emergence of new options within the same or fresh asset classes. There are more products available with in each asset class be it Equity, Mutual Fund, Gold, Real Estate etc.

Derivatives can be used for Hedging, Speculating or Arbitrage. This is a double edged sword and if not used judiciously this can destroy the total net worth of an investor so when to use it and how to use it is a big question for the investor today.

Commodities offer potential to become a separate asset class for market-savvy investors in times to come. This can be a hedging tool also if one has specific interest in a particular commodity. Investors who claim to understand the equity markets may find commodities an unfathomable market.

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