Market Blunders

Fear and Greed grip the market

Difference between a great investor and a poor investor is not that the later makes more mistakes

Mental Attitude

- Maximize profits from winners and minimize the losses.
- Fear, Greed or Ignorance

FEAR

Investor is afraid to admit that he has made a mistake and cut his losses.

- When a stock with a EPS growth rate of 60 percent is trading at Rs.9,000 with a price-earnings ratio of 600 it is dangerous to buy it as a pure momentum play. If the stock starts sliding, it is time to sell before the losses become unbearable. Wipro slid from 9,000 plus to levels of Rs.1,800 before it turned around.

Investor is in a winning trade and books profits too early

- Typically it happened in Infosys. Original shareholders at Rs.110 saw the stock double and triple along with bonuses. Some let go at Rs.500, others let go after the stock crossed the four-digit mark. Yet if they had held on, they would have seen 1400 percent appreciation from those levels.

Investor is frightened to buy in the middle of a bear market because prices are falling.

- You know that nothing has changed fundamentally for Infosys Technologies between Rs.13,000 levels in February and Rs.6,000 levels in May. If the stock was rated a worthwhile investment at Rs.13,000, surely it is a screaming "buy" at Rs.6,000. Yet the panic factor sets in and investors become reluctant to shell out even at half the price. A similar argument holds for any fundamentally sound stock in a bear market.

Investor is frightened to hold on to his portfolio in a falling market and sells near the bottom, thereby maximising his losses.

- Typically this occurs towards the end of a bear market. In November -December 1998, as the Sensex touched 2750 levels, impatient investors sold out in droves. They had bought and held on as the market dropped from 4600 levels. If only they had possessed the nerves to buy more! That was the bear-market bottom and within the year, prices had rebounded more than 50 percent.

The investor panics and sells when the market drops without trying to ascertain long-term impact.

In December 1992, the Babri Masjid came down and there were riots all over India. Between February and April 1993, there were bomb blasts and a second round of rioting in Bombay. Share prices plummeted, dropping 40 percent in those four months. It was a dreadful time and naturally business was adversely affected. But looking beyond the immediate, investors could have seen that the setbacks for business were temporary. Once the political situation came under control, business would rebound. So the dip in prices was a great buying opportunity. Indeed a rebound happened. Starting May 1993, the Sensex moved up from 2000 levels to top out at 4643 points in September 1994.

Greed

The investor loses his sense of balance in a bull market and believes that any stock will double in the next fortnight. He buys rubbish.

Mazda Leasing was a loss-making company that saw a share price move from below par-value in December 1991 to over Rs 2,000 by April 1992. It was a fantastic bull-run engineered by the Big Bull. Investors bought happily assuming that the stock would continue to double every ten days. Yet there was absolutely no justification from the fundamental aspects. After the Scam broke, the stock rapidly went back to below par. One can think of many other examples. This always happens at the peak of a bull market. Mid-East Leasing, MS Shoes, Vardhaman Leasing and Finance- the list is literally endless.

The investor is aware that his portfolio is over-valued but he is holding on momentum alone.

- Zee Telefilms completely dominated the entertainment sector. The company showed fantastic growth rates of nearly 100 percent until the second half of 1999-2000. Yet it was a highly overvalued stock by then. At its peak of Rs.1630, the stock was trading at a P/E ratio of 900-plus. Is there any fundamental justification for holding at those valuations?. A similar argument holds for many other new economy stocks

The investor is so happy at the prospect of fast gains that he blows all his money paying commissions and day-trading on margin.

- Assume a very moderate brokerage of 0.30 percent for a margin trade. Since you don't intend to take delivery you will have to make the opposite trade to close the position at 0.6 percent. Do this once every day and you commissions add up to 144 percent for a 240-session period, which is approximately a year. Add on the opportunity cost at the rate you could have claimed from a safe bank deposit of around 8.5 percent. To just recoup your commissions, you have to register around 160 percent returns. If you are that good, why handicap yourself?

Ignorance

The investor doesn't bother to try and understand the business and use his judgment.

- Your broker tells you that Ranbaxy is a hot stock in a hot sector. Pharmaceuticals are booming, Ranbaxy has R&D, which will payoff in the formation of new molecular-drugs so it will do well. Do you know anything about medicine, bio-technology or the possible impact of new Intellectual Rights Patents? Can you make any independent judgment?. In other circumstances, investors are simply too lazy to look at the balance-sheet in detail. When Zee Telefilms, for example shows an extraordinary profit due to the transfer of a business to a subsidiary or Reliance Industries adds on inter-group sales as revenues, how many investors realise what is happening?

The investor doesn't keep track of current information.

- Birla3M was a company which always had a low discount because the management was considered suspect. Last year, the MNC parent, which is one of the most-admired companies in the world took control and the share price soared. Did you pick up every bit of public information?. There are plenty of other mistakes an investor can make. But these are the elementary errors that day-in, day-out, make a big difference to returns. Obviously every investor doesn't make all these mistakes simultaneously. But most investors make some of these mistakes regularly.