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Defining the different shapes of investment

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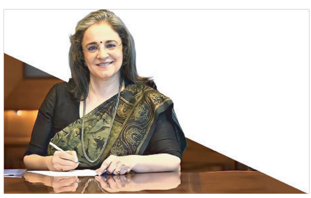
World Investor Week
Special Edition



Message from Ms. Madhabi Puri Buch, Chairperson, SEBI on the occasion of World Investor Week 2022

An informed and empowered investor is the most valuable asset to any country. With this idea, SEBI has been continuously working towards Investor Awareness and Education as a means to Investor Protection.

This year, India is celebrating Azadi ka Amrit Mahotsav to mark the completion of 75 years of independence with great enthusiasm. Over these years, the Indian securities market has transformed in many ways and assisted the economic growth through capital formation.

The markets have witnessed growth, in terms of number of daily transactions, number of new Demat and Trading accounts, increased inflows in products like Mutual Funds etc. In this scenario, it has become essential to facilitate even greater investor awareness and Investor protection.

Protecting investors' interest is one of the prime mandates of SEBI. Towards this end, SEBI has endeavored to ensure the trust of investors in the markets. Investors have been provided with simplified investment processes, transparency through disclosures in the markets and a robust investor grievance redressal mechanism.

At the same time, investors also need to be careful and do adequate due diligence before investing. They should not invest on the basis of market rumors and should deal only with SEBI registered intermediaries. They should carry out their financial planning and choose financial products aligned with their financial goals. Some of the fundamental principles such as regular saving and investing in a well diversified portfolio should always be kept in mind.

With the markets becoming more technology driven, investors need to understand not to share their personal or financial information without proper verification and stay safe.

SEBI has been facilitating awareness amongst investors by conducting various types of financial education and investor awareness activities. One such activity, which is undertaken every year, is the celebration of World Investor Week (WIW). WIW is an initiative of the International Organization of Securities Commissions (IOSCO) and is a global event which is celebrated worldwide by investors, intermediaries and regulators.

This year we are celebrating World Investor Week – 2022 from October 10-16, 2022. The theme of World Investor Week -2022 is Investor Resilience - A Smart Investor conducts research before investing and diversifies his portfolio. A wide range of investor awareness activities are planned across the country for promoting learning opportunities for the investors. These activities include investors' awareness programs, media campaigns, quiz contests, etc.

I am sure that the investors in securities markets, will make use of this opportunity to learn from market experts, understand the do's and don'ts of investing, assess the risk and return of various financial products in accordance with their risk appetite. Prudent, diversified and long term investments can help each one of us create financial security for our loved ones.

I convey my best wishes to all investors on this occasion.

MADHABI PURI BUCH

From The Editor's Desk

Disruption has been the keyword across sectors and markets for some time for now. Like other sectors, the financial sector too has been witnessing a lot of developments and changes. From increased disclosures and regulations to changing the advisory landscape, there seems to be a lot that's going on in the background, especially on the investments front. These 'disruptions' bring in a lot of positives like giving investors a wider choice from an asset allocation perspective for instance. Another major advantage has been the benefits that investors get out of increased disclosures and the growing competitive landscape. But any new development is not without its own challenges. Take for instance the learning curve when it comes to adapting and learning 'new technology' and understanding the platforms that are now available to investors. Another challenge could come in the form of the 'new' asset classes like corporate bonds and Silver ETFs that have now opened upto investors, or the discussion around investing in NFO's. How can an investor navigate through myriad options and ensure that they set their goals right, allocate to the right categories, ensure that they understand their investments, and pick the right financial adviser?

To start with, investor education becomes a very important factor in bridging this 'gap'. What might seem like a huge uphill task could be simplified, largely by ensuring that the right messages reach investors. As we kick off with the World Investor Week, our endeavour is to ensure that we connect with the investment fraternity with a goal to 'simplify investing'. As part of this effort, we bring to you, few thoughts and insights from industry participants and leaders who are aligned towards our goal of 'simplifying investing'. We hope that you will enjoy reading these as much as we've enjoyed putting this together for you. Here we bring to you an article on decoding 5 myths on Mutual Fund investing

Regards,
NSDL - Your Depository

Decoding 5 Myths on Mutual Fund Investing:

A late Sunday evening, an old friend walked into my house as I was making a mental map for what lay ahead of me for the week. As always, discussions ranged from family, kids, festivities, rumours, politics and of course markets. An engineer by background, and at heart, my friend is amongst those who look for quantitative validation for most decisions, particularly when it came to investing. And that's a great trait to have, so long as the fundamentals are understood and followed. Like any other acquired skill, we must understand the basics and the tactics of investing learning and developing our skills. And like a baby learning to walk, first trying to balance herself and then trying to increase her pace and distance covered, often trying to run before walking, and failing, falling - it's all a part of the learning process. It's the same with investing and we only get better as we learn and practice. Coming back to the discussion between the two of us, it centred around the basics of investing and clarifying how a few 'assumptions' that we widely follow may not necessarily be true.

Thus emerged this idea, to talk about fundamentals, to ensure that we build a stronger foundation for investing. To start with baby steps to dispel some myths that we often believe to be true. Sometimes we assume, presume, and let the situation get the better of us when we invest. But the more we learn and understand about the markets, the more we realise how differently it treats every individual investor.

1. **It's the same as Equity Investing** - Mutual funds invest in stocks in any case so why should it be any different? Investing in stocks and Investing in Mutual Funds, aren't the same. This is a huge misconception, and it is important that we understand the differences and look at how an investor should evaluate the two differently. For one, stock prices fluctuate constantly, based on demand and supply dynamics, and of course factors that are specific to the company or the markets in which the stock is traded. Mutual funds on the other hand buy a basket of stocks across various sectors and this gives them a completely different flavour.

   NAV and Stock Prices? Let's take the NAV of a Mutual Fund versus the price of a stock for example. The Stock price represents the value of a share of a company. The stock price also likely reflects expectations of the market from the company in the coming days or years. However, the NAV of a scheme reflects the total value of its assets minus liabilities. A lot of investors tend to buy into a mutual fund during the NFO period based on the assumption that the NAV of the fund will go up. A seasoned scheme that has been around for many years would have a higher NAV because it has made investments that have done well over a period. On the other hand, an NFO with a NAV of Rs.10 will invest its proceeds once the NFO period ends and the value of this could go up by the same amount in percentage terms as that of an existing fund.

Risks and Costs - Stocks, if you get them right, could prove to be cheaper, but carry significantly higher risk – especially if they fail to perform as expected. Moreover, investing in stocks requires an additional level of skill, knowledge and ability to invest in the right manner to ensure that your basket of stocks can perform across market cycles. When it comes to Mutual Funds, a skilled fund manager invests on behalf of the investors, to generate returns on the fund. The manager in turn is backed by a research team and a well-documented process. He bases his stock picks on his views of the market and can diversify the portfolio across sectors. While these factors help mitigate risks to a large extent, investors should consider the expense ratio that's associated with investing in a mutual fund.

2. **Past performance is all that matters!** When it comes to fund managers and market strategists, this year's hero could turn into next year's zero. William Bernstein makes that statement in his book titled The Investor's Manifesto. Bernstein is an American financial author, theorist and neurologist. His words are worth noting. Irrespective of whether the decision is to invest or to liquidate, performance often becomes the sole deciding factor–an error that many investors commit unknowingly. While we vociferously advocate that returns remain an important indicator of how a fund has been able to deliver historically across varied market cycles, it is not the only factor. A more holistic approach is needed when evaluating a mutual fund from an investment perspective.

Top performing fund? But wasn't it in the past? Historical returns do provide an insight into what the fund has done in the past, but its predictive powers are limited. A fund's impressive performance is not guaranteed to be repeated in the future. It is not without reason that the regulator, the Securities and Exchange Board of India, insists on the disclosure along the lines of - Past performance of the Sponsor/ Mutual Fund/ Investment Manager is not indicative of the future performance of the Scheme(s).

Why? For one, performance could change if there is a change in the fund manager. It could change for the better or worse. Having said that, in most cases, It could simply be plain market dynamics; the stock bets that worked in the past may not work going forward. For instance, if the fund manager was stocking up on value stocks and the market favoured them, it would have worked to his benefit. If growth stocks were on a roll and value stocks were being punished, he would suffer. The stock bets that worked in the past need not work going forward. Companies that were part of the portfolio and propelled the fund's overall returns in the past may have either changed significantly in terms of their structure and/or their ability to generate similar levels of return. In contrast, the constituents of the fund itself could have changed affecting the return profile of the fund.

Hence, while returns can be used as a starting or reference point, taking investment decisions solely based on them could prove detrimental to an investor's portfolio.

3. **Timing the markets** Markets are cyclical in nature and witness many ups and downs. In Seth Klarman's words, "The daily blips of the market are, in fact, noise - noise that is very difficult for most investors to tune out."

   Investing based on market movements or trying to estimate market movements could prove detrimental to an investor's portfolio. Consider this - Investors often exit a fund due to its underperformance just in time to see its returns take a 360-degree turn. On the other side, investors tend to buy into a fund when the performance has likely peaked and expect to generate a return. We are often swayed by multiple factors, like our own behaviour for instance. It's important to understand and evaluate why this phenomenon occurred.

   While maintaining a long-term view is important, it is important to understand the reasons for short-term aberrations and their possible impact over the long term. Evaluating a manager's style and comparing the best 'fit' with individual investing preferences becomes essential. Tying your investments to your goals and working backwards, could give investor's a good starting point.

   But how? Investment decisions should be based on a combination of fundamental strength backed by quantitative and qualitative support. Look for consistency of execution when it comes to the underlying strategy of the fund and whether the fund manager's style is in sync with the fund's mandate. And do not expect a blockbuster performance every year.

   A Morningstar study looked at 10-year returns during the period between 2012 and 2021, to find that within the 10 years, mutual funds across equity categories outperformed during 11 months. Any investor who had not remained invested for those 11 months within the 10-year period would have likely exited the portfolio due to its underperformance. Remember that making regular investments through the SIP route or making investments, especially at market dip's will help average out your portfolio returns and yield a positive investing experience over the long term as opposed to trying to time the markets.

4. **Investment Return vs. Investor Return -** Have you ever invested in a fund that was doing extremely well, but realised that your returns on the same fund don't match up?

   It's a common phenomenon that fund returns often presented as part of the documentation do not tie in with the returns that investors experience. Consider this – the marketing materials depict your returns if you made a lump sum investment at a particular point in time and left it alone. But life as we know it could be more complicated than we can explain!

   There could be multiple reasons for this 'gap', ranging from the timing of the investment or redemption, the type of fund that's been considered or an investor's behaviour.

   Why? Investor behaviour is a topic that has been widely researched at Morningstar and a study found that Investor Biases impact everyone. Effective investing is not a skill that comes naturally to most of us, yet we are often overconfident about our abilities when it comes to investing successfully. The study found that most people face biases around prioritising their short-term goals over long-term ones, overlooking the base rates while investing and carried a strong aversion to losses. Although when we know the fundamentals, and we have probably burned our fingers a few times while investing, we still tend to take quick decisions based on what we think is right – decisions that could sometimes throw us back by a few years in financial terms.

5. **Diversification -** We're all too aware of Asset Allocation and diversifying our investments across different asset classes based on our risk appetite. While the asset allocation mix could be different for every investor, a rise or a fall in the markets could impact the asset allocation mix significantly. Here, it's important to ensure that we rebalance and review our portfolios on a regular basis.

   Overdiversification is another factor to steer clear of. We often invest in funds within the same category without realising the similarity or the dissimilarity between the funds. When it comes to investing, there could be a huge difference in the investing styles between the two funds. on the flip side, there could also be a large overlap when it comes to the holdings of say, two large-cap funds.

   Fund managers tend to have different styles, investment horizons and philosophies. Investors on the other hand tend to have varying investment goals and risk appetites. It's important to remember that there is no concept of 'assured returns' or a 'one size fits all' solution in the mutual fund industry. An investor's asset allocation strategy must be well-balanced and in line with their goals. From an asset allocation perspective, if you have multiple funds that invest in the same stocks, that could lead to an increase in your exposure towards a particular stock or set of stocks.

So often, we follow a friend's stock or fund tip and realise that it hasn't worked for us. But having a basic understanding of the fundamentals and following a disciplined approach always works, even for the most inexperienced investors. It's a lot like cooking - you must start with a good recipe so that you can visualise what you want the dish to look like in the end. You need to ensure that you have all the ingredients of the right quality and in the right measure. Much like cooking, a little too much or too little of anything could make or break the dish.

In conclusion, understanding the styles and differences across the investing patterns of different funds can help bring about stability across an investor's portfolio. It prevents investors from taking on additional unwarranted risks as part of their portfolio and brings in a lot of discipline in the investment process

The article is written by
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Investor Awareness Program for Indian Army at 5,600 ft above sea level in Anantnag, Jammu & Kashmir.

on October 14, 2022

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Join our Investor Awareness Programs

NSDL conducts Investor Awareness Programs (IAPs) to help investors to be aware of different aspects of investing. These programs are conducted on different topics of interest to investors and in different languages. The schedule of the forthcoming programs/webinars is published online at https://nsdl.co.in/Investor-Awareness-Programmes.php. We invite you to participate in these programs. We shall be happy to conduct an awareness program for your employees, staff, students, or members. Please write to us at info@nsdl.co.in if you want any such program to be conducted.

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