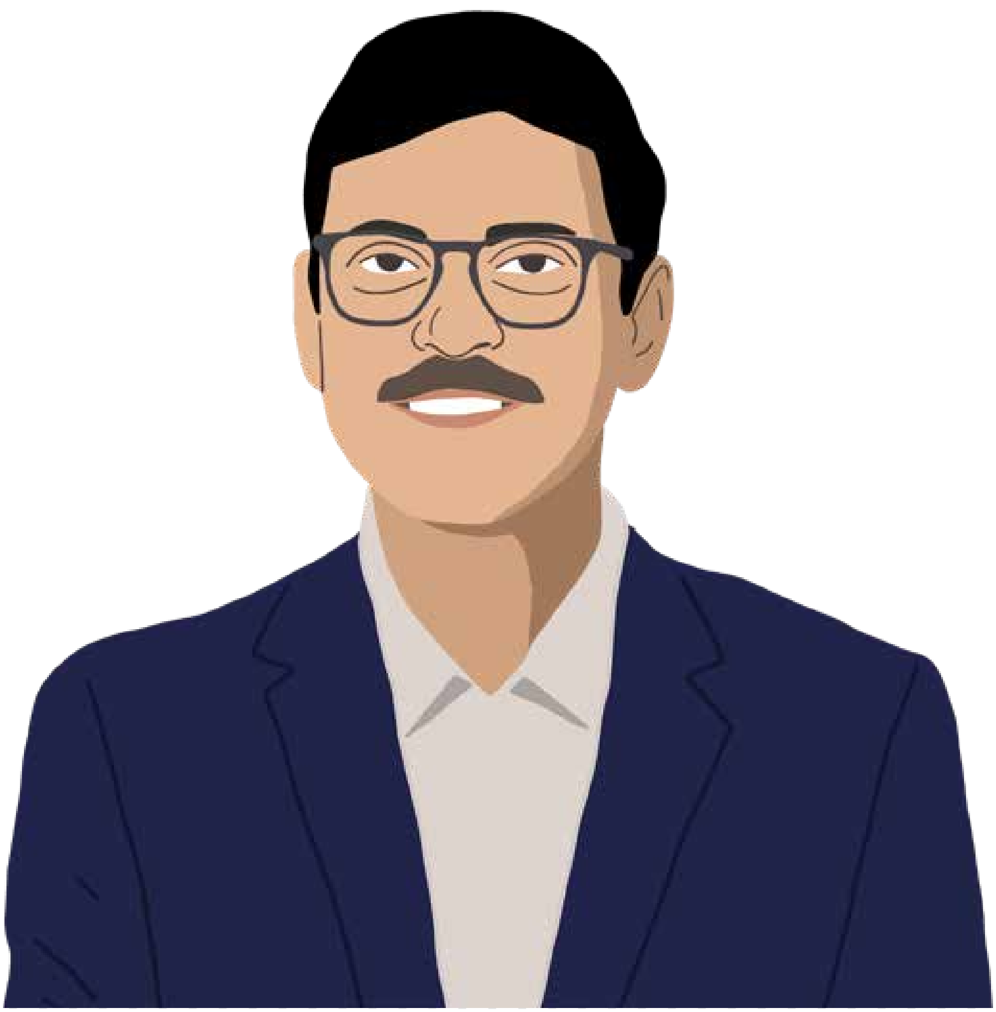
LET ME SHOW YOU
HOW TO GET RICH

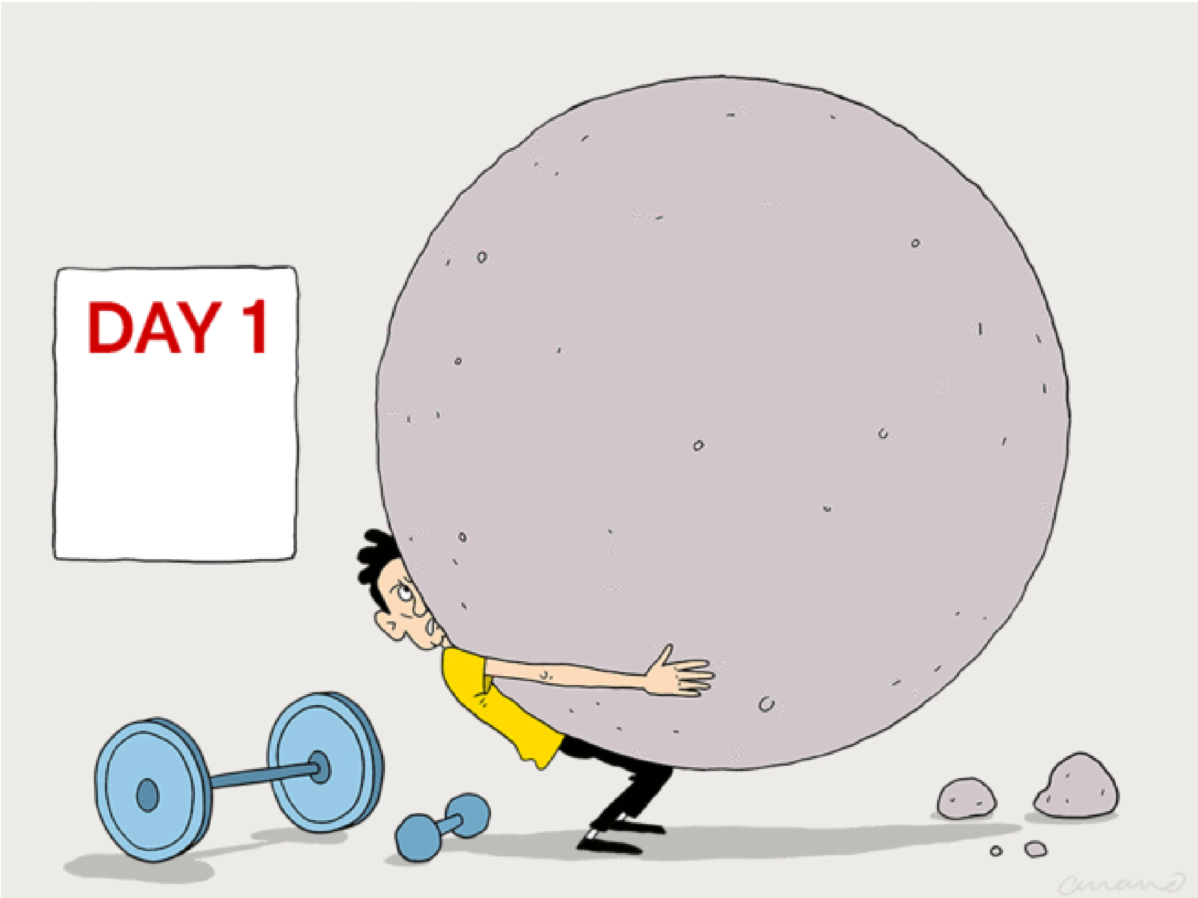
Value Research founder Dhirendra Kumar's
investing secrets for life



Preface

Although this book is mainly intended to help you think right when it comes to growing your money, a significant part of my plan is to remind people that investing – like most things in life – is no rocket science.

Illustrations: Anand Kumar



Do a little bit

The value of trying a little - and successfully doing it - is often not recognised

Originally published on August 05, 2021

The other day, I was reading a blog post about someone's travails with a fitness app. This writer installed this app and then put in the target amount of exercise he would do every day. After a few days, he noticed that if he did not record the targeted amount of exercise on time, the app would immediately offer to let him put in a small amount.

He missed his half an hour, so the app would pop up a message, asking him if he would like to exercise for five or 10 minutes or even less. At that time, he was disappointed.

He felt that the app's logic was making it too easy for him to accept that he would exercise just a small bit. However, he stuck to it. He realised that it made sense to exercise even a small amount. At least he pulled out his yoga mat and did something, even if only for three-four minutes. It may not have made a difference to his fitness but the habit started forming up.

I see the equivalent of this in saving and investing all the time. People think of starting to save and the first thing they do is to go to an online goal calculator and work out how much they need for some future need. It turns out to be a lot - more than they can probably save but full of enthusiasm and determination, they set themselves a difficult monthly goal. They start a large SIP. After a few months - or maybe just one month - they find that they can't pay the SIP so they don't. The investment level falls straight to zero.

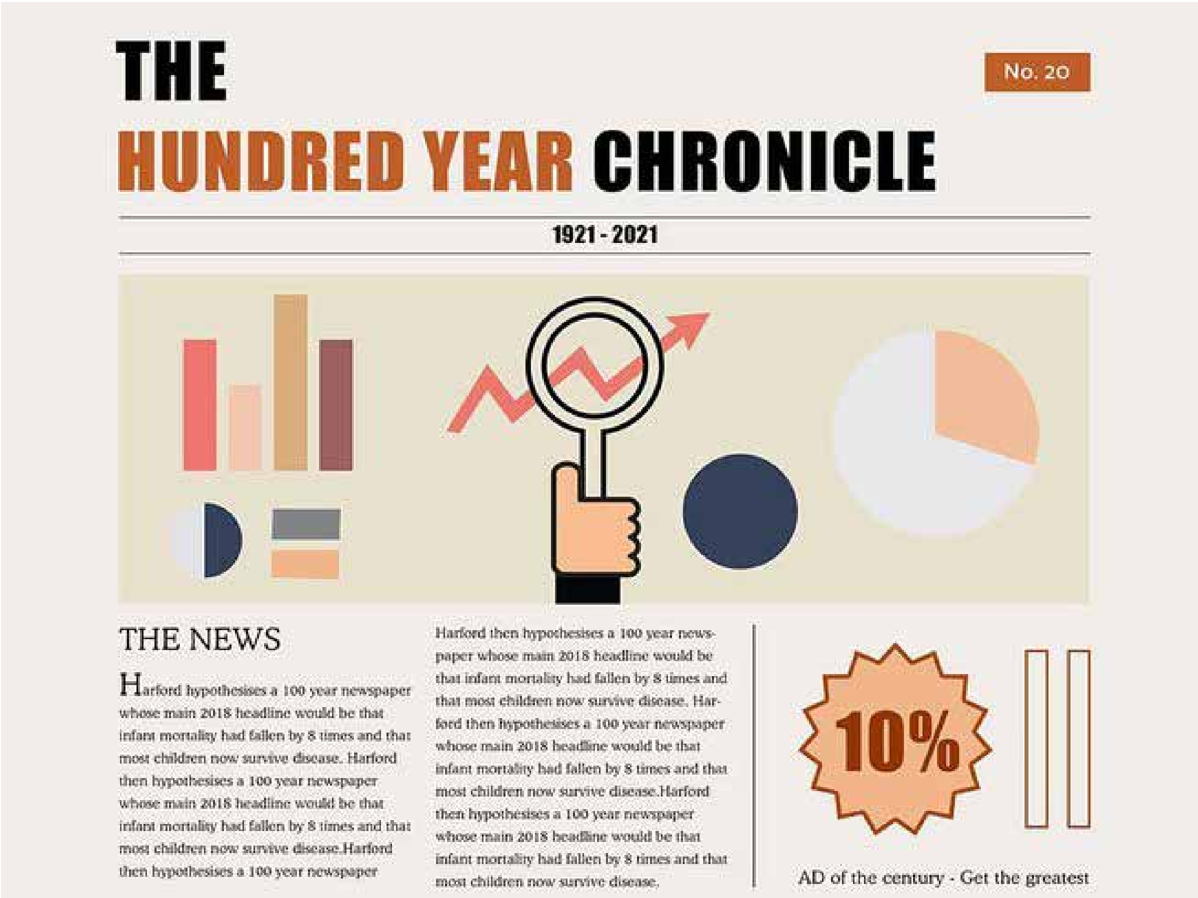
The biggest problem in investing is not where to invest. Instead, it is to invest at all times and keep investing through thick and thin.

The solution is the same as in the fitness app. To begin with, do only a little, only as much as you actually can. Do not go to an online calculator and see how much you need to save to buy a four-room apartment in five years or some such 'stretch target'. Instead, savers should just start with whatever they can realistically save. If it's just a few thousand rupees, that's fine. If it's just one thousand rupees, that's fine too. That's the equivalent of exercising for two minutes, it's the beginning of a habit that will only grow. The important thing is to start somewhere.

I've seen often enough that while the maths of investing regularly, like through an SIP, is important, it's the habit-inducing nature of SIPs that keeps them investing. It's the psychological factor that is the real driver for investing returns and success. That happens because the biggest problem in investing is not where to invest. Instead, it is to invest at all times and keep investing through thick and thin. People invest sporadically and then, stop investing when they don't have money to spare or when the markets fall. SIPs do the job because investing becomes a habit. It gets ingrained in your behaviour patterns, it happens automatically every month and you don't have to overcome any inertia to invest every month. It helps when you start with a reasonable amount that is easy to take out.

The important thing is that there should be no 'zero months', when you have not saved at all. Of course, it doesn't make sense to keep investing the same small amount forever. However, I've seen that the increase happens automatically. Money accumulates, gains build up and then you start enjoying the way your money is growing. Soon, a year or two pass and your income, too, goes up. That's the time people find that they start investing more without any problems.

I do wonder whether mutual funds should facilitate the kind of thing that fitness app did. Right now, whether you are investing directly with the fund or a third-party app, no one bothers too much about a missed SIP instalment. Maybe if a message would pop up and offer a simple way of investing a smaller amount, it could work just as well.



The hundred-year newspaper

The less you know, the more you understand?

Originally published on June 03, 2021

Over the last few days, I've read yet another fascinating book by Tim Harford, 'How to Make the World Add Up: Ten Rules for Thinking Differently About Numbers.' As is obvious from the title, the book is about statistics, specifically about how to evaluate the truth, the relevance and usefulness of the numbers that are thrown at us about the world. This is especially important today when, for the last 15 months, all of us have been subjected to an endless stream of numbers that purportedly tell us something relevant and truthful about COVID.

Rule Four 'Step back and enjoy the view' in Harford's book is something that is specially interesting when one is trying to figure out what part of the information that is being thrown at one is important and what part is useless or worse. The idea is simple - frequency decides what is news. A continuously-on news source like a business news channel has one view of what is attention-worthy news for investors and what isn't. A daily business newspaper like this one has a substantially different view and many of the things that are considered news on a TV channel for - perhaps for an hour or two - do not even find mention in a newspaper. The newspaper itself is different from what a weekly magazine considers to be important news. This is natural since many of the things that seem important in a short time period turn out to be irrelevant in a longer period.

Harford then does a fascinating thought experiment. What if we decrease the frequency even further? What if the rhythm of news was much slower and a global newspaper came out only once every twenty-five years? Such a newspaper that came out today would probably have a small news story about the financial crisis of 2007-08, possibly lumping it together with the dot-com crash. It would have a somewhat more detailed article about the rise of the internet and the smartphone. There would be something about the rise of China. Remember, each edition of a newspaper or a magazine has everything that appears to be news on the scale of the time that has passed since the previous edition.

What about a 50-year newspaper? One issue in 2018 and previous ones in 1968 and 1918? As Harford points out, the big news in the 2018 issue would be that the world had escaped a global nuclear war. The 1968 edition of the newspaper would have focussed on how the nuclear bomb had been invented, been used twice on Japan, thousand more such bombs had been manufactured and global powers had come close to nuclear conflict many times. That this impending conflict had been avoided and the world had not been destroyed would indeed be the biggest news in 2018.

> The next time you get worried about how much your investments have gone up or down in the previous hour or day or week, think about whether you should step back and get a longer and broader view

Harford then hypothesises a 100-year newspaper whose main 2018 headline would be that infant mortality had fallen by 8 times and that most children now survive the disease. A 200-year newspaper, published in 2018 after 1818, would have a huge headline that most human beings were no longer poor and that probably for the first time in a couple of thousand years, a vast majority of people in the world had enough to eat. That's the big news of the last 200 years.

So the next time you get worried about how much your investments have gone up or down in the previous hour or day or week, think about whether you should step back and get a longer and broader view. If I look at the daily figure of the Sensex since it started in April 1979, I would get the news a total of 9,633 times. Of those, it would be good news 5,085 times and bad news 4,548 times. If I got to know about the markets only when a new year started, I would get news 40 times in this year and of those, 30 times it would be good news. If I got news only once in five years (1980, 85 and so on), I would hear about the markets only eight times and it would be good news every single time.

There's a lot of value in stepping back from the continuous noise of the 'news'. The quantity of the information that your brain is subjected to is smaller, but its quality, relevance and truthfulness are higher.

Financial planning in 87 words

Savers who don't understand investing also don't know how to tell good advice from bad. Here's a simple solution for them

Originally published on August 02,2017

It's a catch-22 situation. People who don't understand investing, and are still trying to figure things out, obviously need to take advice from someone else. However, almost by definition, they're also not equipped to figure out whether the advice they are getting is good or bad. Everyone we meet seems ready to shell out financial advice, including friends, neighbours, relatives, co-workers, Uberpool co-passengers, etc., etc. Doubtless, some of the advice may actually have worked for the person who is handing it out but it could still be utterly unsuitable for someone else.

There's an equal problem with commercial advice purveyors. If they are working on a commission (as is almost every one of them), then the advice is certain to be driven by commercial considerations, rather than your interests. So what should you do? Where should you turn for advice?

How about getting your financial advice from a cartoonist, albeit a very famous one? How does that sound? You might be familiar with Scott Adams, whose Dilbert comic strip is an extremely funny yet despairing look at what corporate life is really like. Few people know that Adams has also written some of the best personal finance advice that anyone can get. He calls it a 'book', and its title is 'Everything You Need to Know About Financial Planning'. Except that this 'book' has not been published and is just 87 words (not pages) long.

Everyone we meet seems ready to shell out financial advice. Some of the advice may actually have worked for the person who is handing it out but it could still be utterly unsuitable for someone else.

Here it is, the whole thing: Make a will. Pay off your credit cards. Get term life insurance if you have a family to support. Fund your 401(k) to the maximum. Fund your IRA to the maximum. Buy a house if you want to live in a house and you can afford it. Put six months' expenses in a money market fund. Take whatever money is left over and invest 70% in a stock index fund and 30% in a bond fund through any discount broker and never touch it until retirement.

Adams has a formal education and a professional background related to finance. His bachelor's degree is in economics. He also has an MBA and has worked in a bank for eight years. And yet it's so wonderful that despite these handicaps, he still talks sense about personal finance. Of course, what probably helped was that during his years as a banker, he must not have paid any attention to his professional work. Instead, he must have been just observing life in the bank, and storing away material for his future career as cartoonist.

Adams says that he did start out planning to write an entire book on personal finance However, by the time he had thought through in detail what the book would have and simplified everything to the logical end, he just had these 87 words left.

The great thing is that these 87 words do successfully encapsulate everything you need to know in order to plan your entire life's savings and investments. Obviously, in India you would replace the 401(k) and the IRA (US retirement planning instruments) with appropriate Indian equivalents like your mandatory PF, NPS and annual investments in ELSS funds. And as for the 70:30 advice at the end, all you have to do is to choose two or three good balanced funds and start SIPs in each.

Scott Adams has some great comic strips about the investment industry and what he has called the 'financial entertainment industry'. In one, the evil Dogbert is explaining his plan to launch a mutual fund, "We're getting into the financial services game. That way, all our products can be imaginary. We'll start ten mutual funds, each with randomly-chosen stocks. Later, we'll build our advertisements around whichever one does the best purely by chance. My goal is to be the premier provider of imaginary expertise." I'm sure some Indian mutual fund CEOs will recognise this strategy from personal experience.

In a following strip, Dogbert is being interviewed on a business channel. The anchor asks him, “It’s reported that your fund is the highest performer of the decade. Tell us how you made that happen.” Dogbert then says in an aside to the reader, “Apparently, this guy will read anything you hand to him.”

Clearly, Scott Adams has a deep understanding of a lot more than office life.

Just do the simple stuff

Keeping your investments simple means that you always understand what is happening and what you must do when things go wrong

Originally published on December 03, 2021

For decades now, as technology companies took over the world and started transforming practically every industry, the world's most famous investors ignored it. For all practical purposes, Warren Buffett and Charlie Munger missed the technology bus. They started to invest in Apple and IBM only recently, after the former has transformed into a consumer durables company and the latter into a business services company. Why did they avoid technology? And more importantly, is there anything that us mere mortals can learn from this?

In the years before that, Buffett and Munger often said that they did not invest in the stocks of companies whose businesses they did not understand. A simplistic response would be that they missed out on a lot of great investments

In the case of personal finance products, simplicity is not just something useful or helpful, it's absolutely necessary.

because of that. Despite always having billions of dollars of investible surplus, they never made a dime out of stocks like Google and Amazon, which delivered more than 20X for investors over these years.

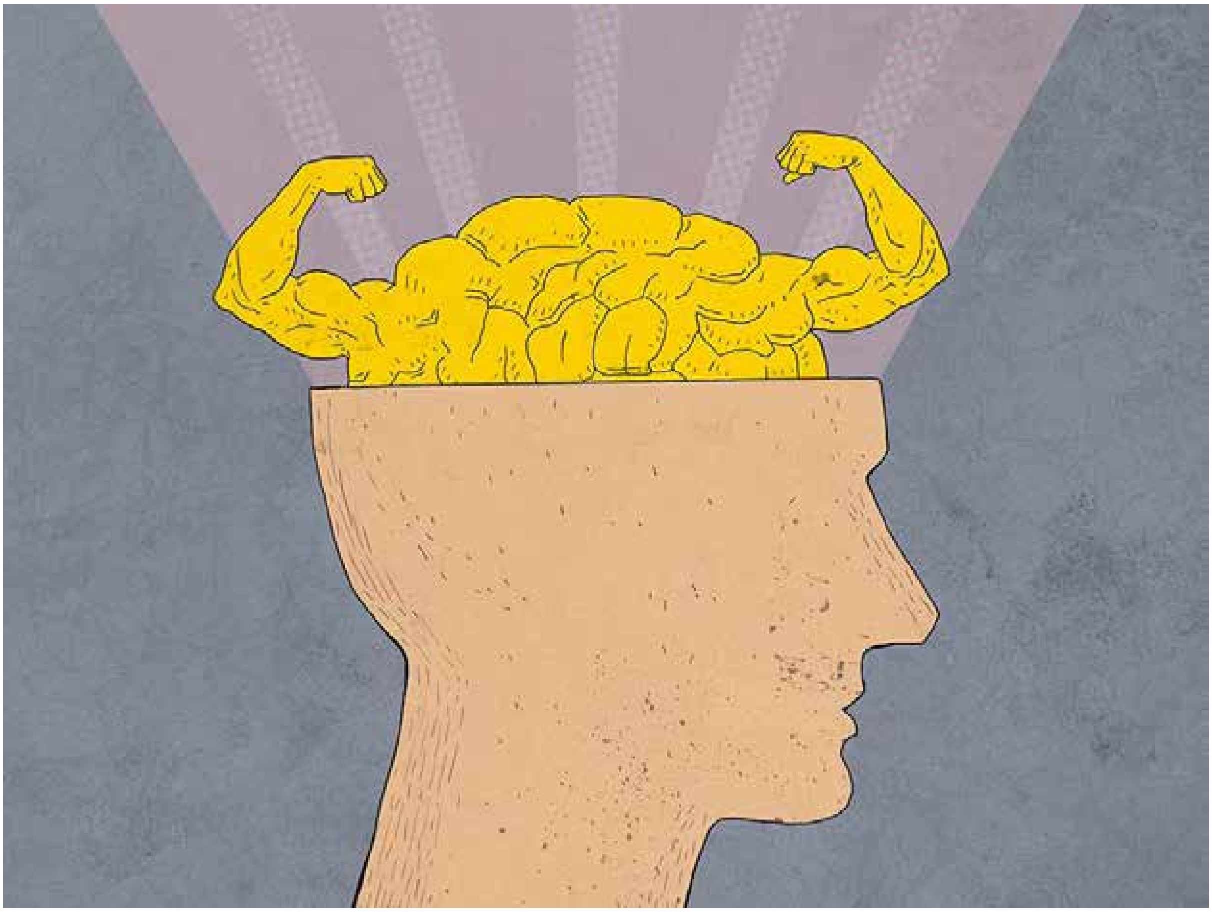
And yet, the duo is pretty sanguine about the opportunity lost. The reason for that is that they were still the most successful investors in the world at that scale. They were successful because they invested in businesses they understood. In hindsight it's easy to say that they missed out on Amazon and Google. However, they also missed out on Pets.com, Webvan, Myspace and other expensive failures. Since they did not understand the business, they were just as likely to invest in these duds as they were to invest in Amazon and Google. After all, the great media moghul, Rupert Murdoch, did buy Myspace for US$ 580 million and then sell it four years later for US$ 35 million. To avoid this 94% loss, all Murdoch had to do was to learn from Buffett and Munger and not touch investments that he did not understand.

And that's exactly what we should do too.

No matter what product or service we're buying, nothing impresses us more than features, jargon, and complexity. Perhaps our modern technological world has mentally trained us to accept that most of the new wonders of the world are too complex to be understood by most people, and therefore, anything that is complex must be good. Unfortunately, in personal finance, this idea is fatally wrong. In the case of personal finance products, simplicity is not just something useful or helpful, it's absolutely necessary. The reason is simple - if an investor does not fully understand a financial product or service, then he or she has no way of telling whether it is even minimally suitable, regardless of how good its seller may claim it is.

And how can you ensure that you understand everything? The easiest way of doing so is to keep things simple. Unfortunately, the message that we hear is the opposite. When I look at the market for savings and investment products today, and see the resulting investment portfolios that people are collecting, it's clear that there's a strong need for a self-aware and aggressive minimalism. The impact of marketing messages is to promote the idea that your investment needs are best met by portioning out little bits of your savings into a large number of investments. If you would like to be part of the minority of sensible investors, then you should stick to a minimalist approach. Simplicity is needed not just in the types of investments that you use, but in your investment portfolio as a whole. If someone has - and this is very common - an investment portfolio that has 20 different investments of varying amounts and periodicities, even if those investments are simple, the whole situation is complex and hard to understand.

Ninety-nine savers out of 100 need to do nothing but have a basic menu of a certain amount of emergency money, a hefty term insurance policy, and no more than three to four mutual funds, one of which can be a tax-saver. Such a combination is simple, to the point that anyone can understand everything about it and track it to the extent required.



A mind trick for yourself!

A neuroscientist explains the trick you must play to manage your money well

Originally published on December 06, 2021

The other day, I came across an article about personal finance in which the author tries to organise his personal finances by following advice from a neuroscientist. It sounded like a gimmick at first - why would a brain scientist's advice about money be any good? However, it turned out that the advice was not about saving at all, but about the process of decision-making. It applied some well-known facts about how people make choices and came up with what is essentially a new and scientifically underscored reason for something that we should all be doing anyway.

It could be especially helpful to younger people who are struggling to save and invest.

The neuroscientist in the article bases his advice on the interesting idea that making choices and taking decisions is tiring. Throughout our day, whether we go out or are at home, we are faced with many choices. We choose what to eat, what to wear, which route to take to work, when to have coffee, what to say to whom and so on. These are all small matters, but the thing is that they all add up. They exhaust us mentally in an incremantal way and sap our capacity to make big decisions. This may sound like a surprise but there's a good amount of research supporting this and you can also google it to be sure. Both important and mundane decisions can be difficult to make.

One of the hardest decisions to make is how much to spend and how much to save. However, the problem is that unlike some other decisions that one has to make, there is a default available here which is actually the worst. Think about it. Let's say you are one of those people who have a hard time deciding what to order when you go to a restaurant. However, no matter how much you agonise over the menu, eventually, when the waiter starts giving you dirty looks, you'll jab your finger at something. Whatever it is, you will get something on your table, and once it's there, you'll eat it. It's the same with so many decisions like what to wear and which route to take to work.

Saving is not like that, not just for younger savers but even for many older ones. If you don't know how much to save (where to save comes later), then there's no equivalent of eventually ending up ordering something or the other from the menu. There is no menu. The month ends and you save nothing. However - and this was what the neuroscientist was telling us - even if you save, the process of saving and deciding (on the amount and where to save) is exhausting.

Make saving your first priority every month. Try to save at least 15 to 20 per cent of your income.

There is so much to spend on, and it is so difficult to decide whether each individual purchase is important enough for it to take a chunk out of what you can save. You could buy a car with a ₹8,400 EMI, or you could buy the one with a ₹9,300 EMI. The difference of ₹900 a month is surely worth a slightly roomier, safer, nicer looking car. You could order from a nice restaurant or some fast food, or even some cheap street food from the neighbourhood. How much of a difference would it make?

The solution is simple, and it's the one thing that we can actually learn from the government. Make a budget! According to research, the only way to make better decisions is to make fewer decisions. The recommendation is simple. Pick a number that you must save. Make rough estimates of all your expenditures and do a certain amount of tracking of where the money is going. However, make saving the first priority every month. Try to save at least 15 to 20 per cent of your income. Then, in a sense, you are free from the stress of deciding whether an individual spending decision amounts to splurging or not. You've already saved what you planned to, so if something is a bit of a waste, so be it.

Other people's knowledge

Learning from other people's knowledge and experience is hard to do, but it's worth the effort

Originally published on July 20, 2020

Apart from being an investing legend and Warren Buffett's lifelong business partner, Charlie Munger is one of the great storytellers on business and investing. And obviously, each story is something that you can learn from. If you have the inclination, order a book named 'Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger'. It's a little expensive, but actually worth far more than you will pay for it. In other words, it's a value buy, as it should be.

Here's a typical Charlie Munger story, funny, yet with a deep point. Munger narrates it thus: I frequently tell the apocryphal story about how Max Planck, after he won the Nobel Prize, went around Germany giving the same standard lecture on the new quantum mechanics. Over time, his chauffeur memorized the lecture and said, "Would you mind, Professor Planck, because it's so boring to stay in our routine. [What if] I gave the lecture in Munich and you just sat in front wearing my chauffeur's hat?" Planck said, "Why not?" And the chauffeur got up and gave this long lecture on quantum mechanics. After which a physics professor stood up and asked a perfectly ghastly question. The speaker said, "Well I'm surprised that in an advanced city like Munich I get such an elementary question. I'm going to ask my chauffeur to reply."

Of course, the point is not Planck's chauffeur's wit and presence of mind, but something else entirely. As Munger puts it: In this world we have two kinds of knowledge. One is Planck knowledge, the people who really know. They've paid the dues, they have the aptitude. And then we've got chauffeur knowledge. They've learned the talk.

In investing, all of us start with chauffeur knowledge, some of us are lucky enough to somehow upgrade that to Planck knowledge. When we first start investing, we observe what is happening around us, we listen to what appears to be knowledge and experience and we learn to imitate some aspects of it. It works for a while and if we are lucky then it works for quite a while. However, sooner or later, reality stands up and asks a question for which we have no answer. There is no substitute for experience.

Nowadays, there are any number of equity investors who have been asked that question by the markets and they are looking around for an answer. In theory, we all knew that at some point, we will be asked that difficult question. However, nothing actually prepares us for the real experience than, well, the real experience itself.

You've been investing for a few years through SIP, perhaps about Rs 10,000 a month in a couple of funds. The gains are comfortable, the value of your investments have grown to about Rs 8 lakh. You are now really sold on this idea of going on with your SIPs for many, many years. There have been some ups and downs, the value has gone down by maybe 5-10 per cent a few times but has recovered nicely.

And then Covid hits. The Rs 8 lakh is now down to Rs 5.5 lakh in a matter of days. Then it recovers a bit, then it stalls, then recovers a bit more, then drifts around. Now you don't know what to do. I mean, yes, IN THEORY you know what to do. But the problem is that if this is your first time then what you have is chauffeur knowledge, not Planck knowledge. Unless you have lived it, and experienced it and then come out intact on the other side, it's hard to actually do it.

So why am I telling you this? Only because if you go through with the experience without panicking, you will have gained experience without damaging your savings. You will still learn to get through the hard times, but in the best way possible - by using other people's mistakes as experience, and not your own.

To have more, save more and save longer

The answer to getting to your financial goals is surprisingly simple

Originally published on December 06, 2021

How can you make more money out of your investments? There are many, many answers to this question, but only two sure-shot ones. One, invest more and two, give it more time. Preferably, do both. To some people, this must be sounding like a joke or worse still, a mocking answer. But it's absolutely true. These are my personal solutions, the ones that will always work. I know that investment analysts are always supposed to come up with some magical technique, some combination of investment types and timings that will create some unlikely miracle like, for example, turn Rs 20,000 a month for 10 years into Rs 1 crore. Way too many people are looking for answers to questions like that.

However, some things can't be done. Actually, the real problem is that this is not an intellectual exercise. At the end of that time, there is some real-life goal that has to be met by the savings. However, having an over-optimistic calculation just encourages people to save less. The reality is that we have no clue about what will happen. Everything that anyone says, whether an individual investor or an investment analyst like me or anyone else, is just a projection of assumptions and past trends. After 21 months of the Chinese virus, surely that's obvious.

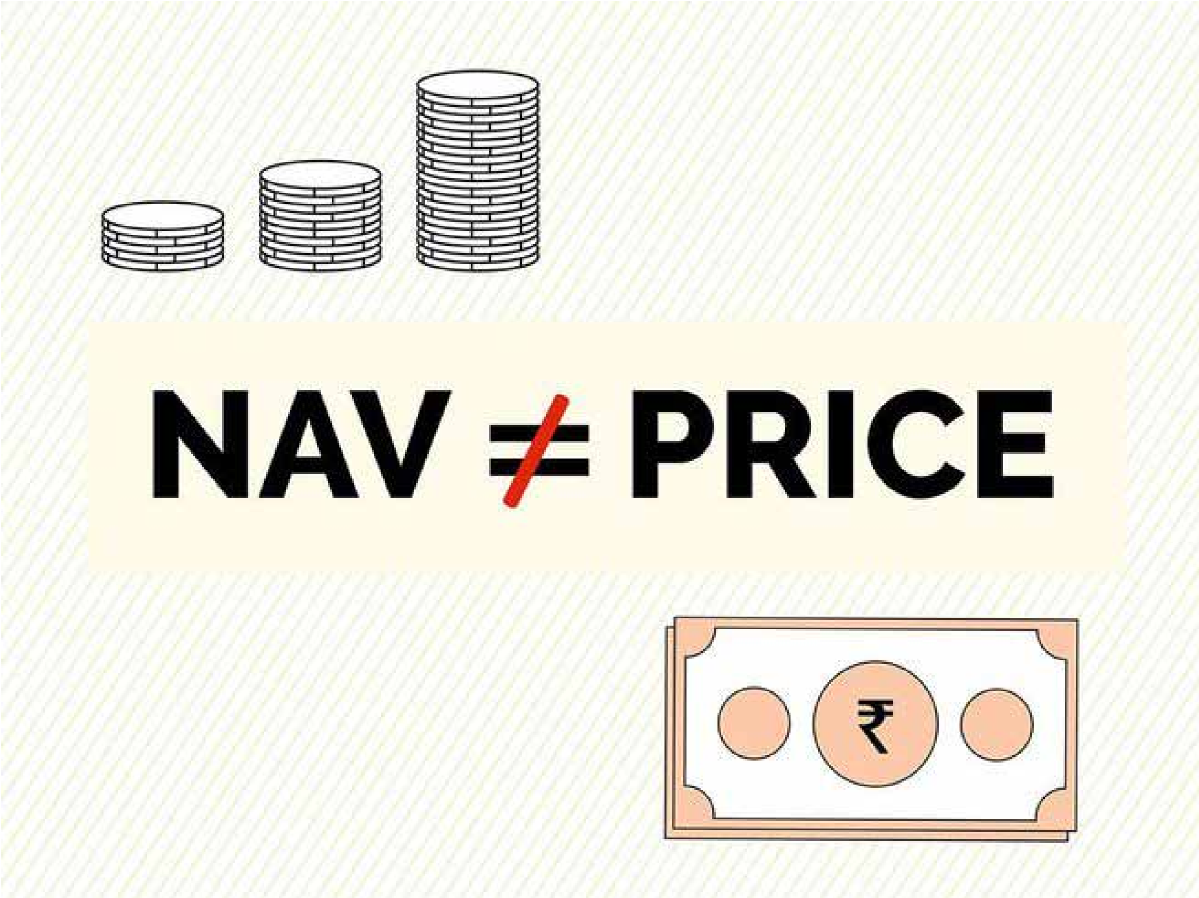
The correct thing to do is not to look for a more accurate prediction involving a higher return investment, but to realise that accuracy is not possible. What is the way around this? To appreciate that the unexpected will almost definitely happen. Moreover, surprises are overwhelmingly more likely to be negative than positive.

Most people just save whatever they can or they save some arbitrary number driven by tax-saving needs. Instead, we'll have to start projecting future needs and projecting backward from there to see how much we need to save.

To have more, save more and save for longer. The biggest problem is that the overwhelming mass of people don't save or don't save enough. Whatever they do save, they do it without real awareness, without projecting into the future and thus without triggering the thought process that would lead them to save more and save better. In fact, all of us in the investment media are culpable because we try to focus so much on where to invest. This sends out a subconscious message that if your savings are not growing to some level that you want them to, then the way to solve that is to find a better investment. This is the dominant theme in all investment media and in all questions that savers ask about money. However, the true answer often lies in the fact that most savers don't save enough.

What's making this worse is longer life spans. In India, life expectancy at the age of 60 is now 17.8 years. As recently as 1990, this was 14.8 years. That large a change in the average means that some people - especially those with access to better nutrition and healthcare are living a lot longer. We can see this around us. It's very likely that this trend will continue. The flipside is that your retirement kitty may have to last 25 or 30 years. To do this, your savings will have to earn better returns - which, as we've seen - is likely to be a challenge. Even if they can, there is no alternative to saving more.

Most people just save whatever they can or they save some arbitrary number driven by tax-saving needs. Instead, we'll have to start projecting future needs and projecting backward from there to see how much we need to save. The best thing to do is to be pessimistic in these calculations - assume that needs will be higher and returns lower. This is not easy to do actually. The human mind (at least the mind of the kind of humans who invest!) gravitates towards optimism. Optimism is a great quality, but not while you are projecting your investment returns into the far future.



The price of misunderstanding price

NAV is not price and that's the source of many investing mistakes

Originally published on June 29, 2021

In three decades of interacting with mutual fund investors, I have faced many surprises as to the kind of misunderstandings that people can have about the mechanisms of how mutual funds work. Unfortunately, NAV and dividends, which are the two most basic parts of the mutual fund, are the subject of the most misconceptions. With dividends, SEBI has recently made a start by abolishing the word altogether and renaming mutual fund dividends 'Income Distribution cum Capital Withdrawal'. That's accurate but a rather large mouthful so the common term is going to be IDCW. That's accurate, even if it will take some getting used to.

However, NAVs are a different as well as a much bigger problem. A few days ago, I came across a stunning example of how the term can be misunderstood. An acquaintance wanted some advice on his mutual fund investments but wanted to do the research himself. He had one particular fund, an equity mid-cap one, which was a little dubious so I asked him to do his research on Value Research Online and see if he could identify a better alternative. After a week or so, he came back and proudly told me that the closest alternative to the mid-cap equity fund was a liquid fund. When I asked him why he explained that the NAVs of the two funds were almost the same!

The only purpose of NAV is to compare a fund's NAV to its own past NAV to evaluate performance, it has no other practical purpose for investors.

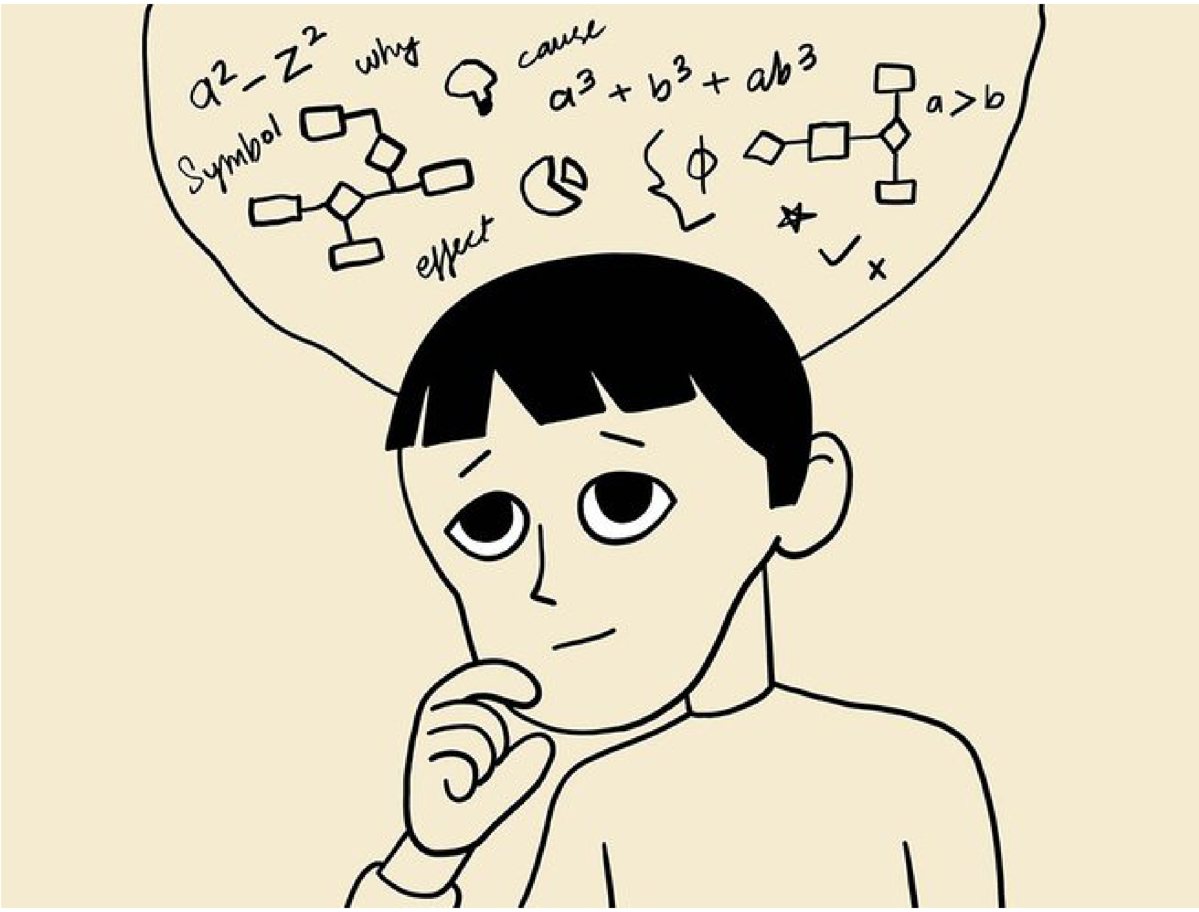
The NAV of his mid-cap fund was ₹37 so he had found a liquid fund whose NAV was ₹33. For all of us who know about mutual funds, this is a flabbergasting error but it seemed like a natural thing to him. I must point out that I am neither blaming this person nor am I mocking him in any way. He is a successful businessman who has started from scratch and found considerable success in just 15-20 years. He understands money very well in the way that an entrepreneur does.

In fact, I am more inclined to blame the way the mutual fund industry, salesmen and we experts talk about NAV, often treating it as the 'price' of a fund which you pay to 'buy' fund units. If you wanted to buy a car which was priced at ₹5 lakh and you were told to find an alternative, you would start looking for other cars which cost around ₹5 lakh. If NAVs are often loosely referred to as the price of a fund, then people will bring their existing mental model of what the word means to mutual funds as well. The fault lies not with new investors, but the way the jargon assumes knowledge that people don't have.

It stands to reason that my friend can't be the only person who formed this idea. If one person thought this through, many others must be doing so. Note that unlike the dividend terminology, there's nothing that the regulator can do. The term 'dividend' was technically incorrect but 'Net Asset Value' is correct. It's our way of referring to it, which equates it with the price that is wrong. The jargon leads you towards the idea that a fund with a lower NAV is better because it's cheaper. It's possible - even likely - that you are being sold the fund by a salesman who is actively pitching a lower NAV as a reason to buy a fund.

This idea is wrong - low or high NAV is irrelevant as a characteristic on which to base the decision to invest in a fund. In fact, this idea is so thoroughly wrong that it can serve as a good indicator for detecting a fund salesperson or 'advisor' who is deliberately misguiding you. Remember this: anyone who is asking you to choose a fund because it has a low NAV is misguiding you. There are no exceptions to this rule.

The only purpose of NAV is to compare a fund's NAV to its own past NAV to evaluate performance, it has no other practical purpose for investors. The strange thing is that even stock price is not the price in the normal, everyday meaning of the word, but more on that some other time.



The algorithm in your head

What you see is not what you want but what you will 'engage' with. So is this an excellent way to learn about investing?

Originally published on April 21, 2022

Algorithms are the new symbol of good as well as evil. Any number of new products and services claim to be able to function magically better because words like AI, ML and algorithm have been sprinkled on them. On the other side, algorithms are almost the pure embodiment of evil, which social media and other digital content companies use to manipulate you.

As I was doing some background googling on this, I came across a succinct and clear analogy of this problem. In this video, the narrator said that imagine a group of teenagers who go to a party. On the way back, one of them posted on some social media that the party was nice, and everyone had a good time. Another one posts that the party was terrible and criticises the host and the fellow guests. It's human nature that those reading the two messages will pay more attention to the second message and share it further in larger numbers.

So far, so normal. However, the problem starts after this. The algorithm 'notices' this behaviour and then starts optimising for 'engagement'. More and more negative messaging gets shoved on to their screens, leading to a spiral of stronger reinforcement.

Transpose this to savings and investment content on social media and other digital media. Why is it so heavily biased towards the kinds of investing activity that is supposed to generate quick and outsized returns? Why is there so much content on crypto and which stocks will double over the next week and so on? The reason is the same. Such content is more likely to get 'engagement', as the content companies call it, and thus increasing their revenue. The behaviour of the systems is tuned for clicks and shares and forwards and this is the kind of content that generates all that.

Eventually, this will start having a serious effect on the beliefs and behaviour of new savers and investors. In fact, I already see it happening. There's no shortage of young people who believe that crypto or day-trading is the only way to invest. They think of long-term mutual funds or stocks investments in the same way as they feel towards owning a rotary dial phone - something that belongs to the past and is completely outdated.

You could argue that these are attitudes that build upon the instinctive attraction toward quick and outsized returns that is already there in almost everyone's way of thinking, and you would be right. That's very much what my point is. The instincts are there, but the logic of the engagement-enhancing algorithm relentlessly enhances and reinforces it. It's just like the example of the partying teenagers. There is one article or video or tweet on making a sensible, diversified set of investments that'll generate 5-6 per cent above inflation for a decade and make you wealthy and another one on doubling your money in three months.

Social media is so heavily biased towards the kinds of investing activity that is supposed to generate quick and outsized returns because such content is more likely to get 'engagement'.

Here's the most important part: In the pre-algorithm days, the question would have been which one you will click on. However, nowadays, that decision has already been made for you. You will be shown only the second one because that is what you are likely to click on, and that's what will make someone more money. Most of the time, the decision has already been made for you.

The question is, what can you do about this? I'm not here to suggest any legal or regulatory changes because it's hard to imagine how those would work. Instead, what are you going to do about this on a personal basis? I think the answer is self-evident. Be sceptical - all the time and about everything. Be sceptical not just about what any piece of content is saying but about why it is being shown to you at all. Always consider the contrarian view and go out looking for it. It's your attention, your money, and your investments. Optimise it for yourself and not for someone else's business.

Nothing to do

While many people will try to persuade you otherwise, the bulk of 'activity' in investing is actually doing nothing

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The other day, I saw this tweet from Nassim Nicholas Taleb where he was talking about vacations: Don't go to resorts where you meet "achievers" on commoditized vacation actively trying to relax. Go to villages (preferably your village of origin) & interact with locals who can teach you how to do nothing when there is nothing to do.

While this is no doubt true about the vacations some people take, the most interesting part is actually even more relevant for investors and that's the phrase 'how to do nothing when there is nothing to do.'

Doing nothing is an activity that is not normally associated with success in anything. In fact, it is associated with laziness and failure. That's probably true for most things in life, except not in investing. It is true for employees, for students, for sportspersons, for politicians and certainly while driving on Indian roads. Therefore, we sort of assume that it must be true in savings and investments.

Think about what activities would normally be associated with investing? I guess most people would think that investing consists of activities like studying investments, choosing them, monitoring them, looking for new ones, weeding out old ones and so on and so forth. That's a lot of things to do. If you have 10 or 20 investments (and many people have more), it could almost be a full-time activity.

This whole idea of continuous action is actually quite misguided. When I think of the actual activity that should take up most of the time of investors, then it should be nothing. For most - almost all - of the lifetime of an investment, you should be doing nothing about it. The bulk of the activity (although that's not the right word) of investing is waiting. Waiting for months and years while your investment grows, powered by the monthly drip-irrigation of your SIP instalments.

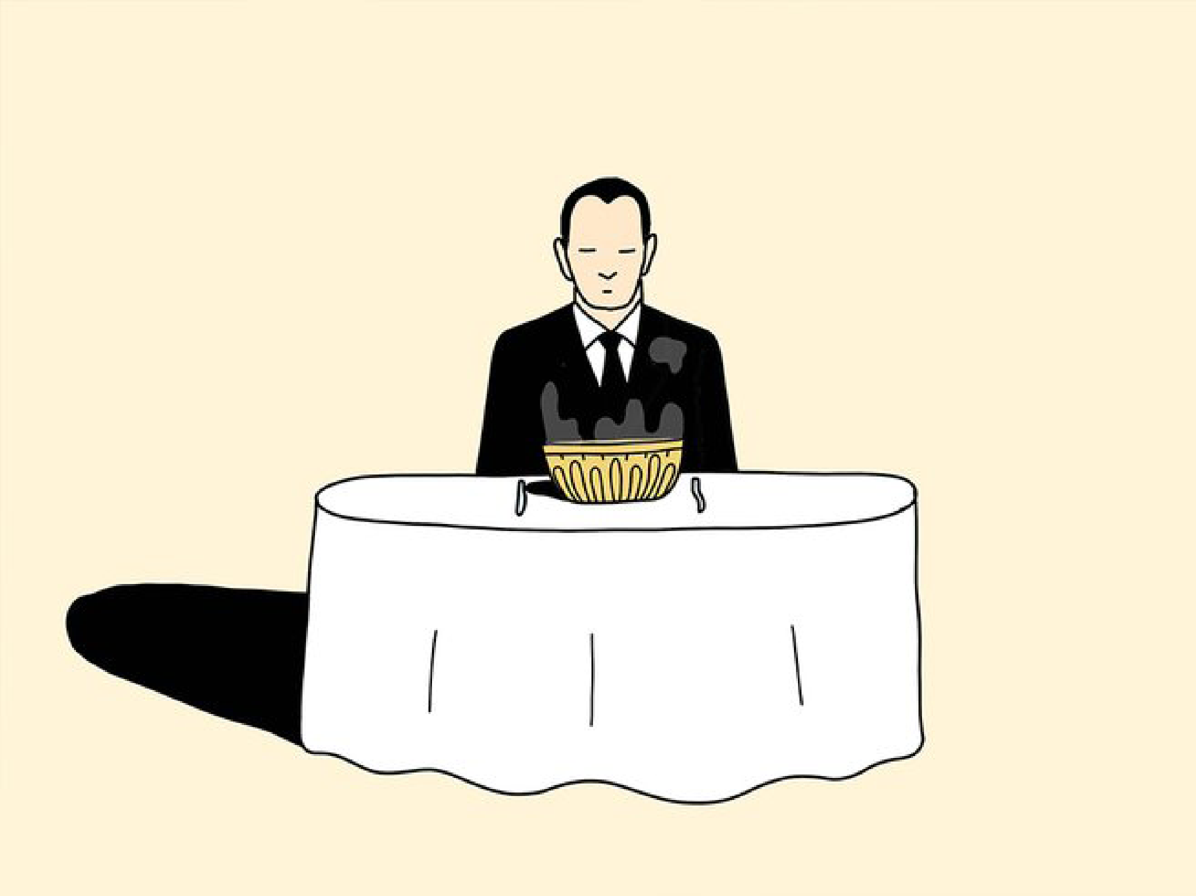
The problem is that there are far too many people who are actively trying to persuade you otherwise. Indeed, their livelihood depends on it. Much of the investment advice industry is focused on giving you the impression that investing consists of doing things and investors who do more things will earn more. Somewhat counter-intuitively, this is not true for investing. Investors who think that this is a true act when they shouldn't and do worse than others. As someone said, a bored investor is a dangerous thing.

One driving factor behind this action is also the investment entertainment industry, which claims to be the investment news media. The impression they try to create is that short-term events matter to investors. This is simply wrong. They do not. I get a lot of mails from people asking me for investment advice and for ways out of their investment problems. The problems always arise out of things that the investor did or didn't do over many years and sometimes decades. Not just that, solving those issues always involves taking actions that need to be sustained over the years. I never come across someone who has problems with an investment portfolio because he or she didn't stay glued to the breaking news and react to events rapidly. Rather, the very opposite is true. Many investors do badly because they pay too much attention to the news and react too much to events, well in advance of the real purport of those events becomes clear.

We're currently living through the biggest proof of this phenomenon that we have seen in our lifetime. Since February 2020, the apparent impact of COVID on your investments has changed course rapidly. Investors who acted precipitately ended up doing badly through their actions. Unless there was some huge and glaring anomaly in your investment portfolio, very little needed to be done.

The great Charlie Munger put it best last year. Despite $125 billion in cash and assets at rock bottom pricing, Buffett and Munger were sitting on their hands. Nothing tempted them. As Munger said about COVID, "This thing is different. Everybody talks as if they know what's going to happen and nobody knows what's going to happen."

That's actually true of most events.



A starter pack for mutual fund investors

Some types of mutual funds are specially suited for investors who are starting off, or who want something simple

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Even if you can afford a fancy car as your first one, it probably makes sense to buy a slightly old second-hand one as your first car. For all kinds of reasons that are self-evident to any sensible person, a second-hand car makes a good 'starter car'. On Wikipedia, you can also find information about a peculiarly American concept called 'starter marriage' but we won't go into that.

In a somewhat similar (similar to cars, not marriages) fashion, there are also what one could call 'starter funds'. These are categories of mutual funds that, besides their simple investment characteristics, are especially suitable for investors who are just dipping their toes into mutual fund investing. Moreover, starter funds are actually not just starter funds, but simple funds. That is, they are funds that can serve the entire investment purpose of savers who like to keep things simple and do not have the time or the inclination to spend too much time studying investments.

The first type of mutual fund that serves as a good starter fund is tax-saving funds. Tax-savers' utility as starters comes because of their legal status as tax-savers, as well as their three-year lock-in period. Oftentimes, beginner equity investors are tempted to pull out their investments when they hit their first period of volatility or declines. However, in tax-saving funds, because of the lock-in, they end up getting good returns. Three years is almost always a long enough period for the long-term returns of equity to do their magic. By the time the lock-in ends, the newbie is convinced about the value of patient investments in equity-based funds.

After tax-savers, the first real category of starter funds, as well as simple funds, is hybrid funds, or as they are more commonly known, balanced funds. The role is simple - investors need a set of characteristics, chief among them being a spread of assets at different points on the risk-return spectrum, asset allocation between them, and asset rebalancing on some defined basis when the asset allocation gets out of whack.

When equity is growing faster than fixed income - which is what you would expect most of the time - you would periodically sell some equity investments and invest the money in fixed income so that the balance would be restored. When equity starts lagging, you periodically sell some of your fixed income and move it into equity. This implements beautifully, the basic idea of booking profits and investing in the beaten-down asset. Inevitably, things revert to a mean, and that means that when equity starts lagging, you have taken out some of your profits into a safe asset, reducing the volatility that will panic a new or even an old investor.

You can do all this manually, so to speak. You can choose a set of debt funds, a set of equity funds and use the tools on Value Research Online to monitor and correct your allocation. Or, if you are just starting off, you could try out a type of fund that does it all in one package. This is low-effort, convenient as well as tax-efficient.

Why does this approach work? The two types of financial assets - equity and debt - are not just different, but complementary. There are two major ways that an investment can make money. One, by lending money to someone who pays interest on it, be it a business or a government. And two, by becoming a part-owner of a business, as in having a share in it. The characteristics of the two are such that combining them is the best approach.

Under SEBI's formal codification of different categories of funds, we now have several categories of hybrid funds that can fit different needs of asset allocation. They range from the very conservative, which are essentially fixed income funds with a light garnish of equity, to the very opposite. As such, any investor can find something that is perfectly suitable for their needs. So the best option would be if one could just pick one or two mutual funds and start SIPs, and the funds themselves would do the balancing, which are hybrid funds.

A little bit of freedom

Financial freedom is not an all-or-nothing goal. A little bit of freedom is also worthwhile

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I get asked for a lot of financial advice and as you would expect, some of the questions are easy and sometimes they are difficult to answer. Sometimes, the questions arise from the saver having inputs, as in, I have x amount of money - what should I do with it? Sometimes it is about outputs - I need x amount in five years so what should I do to make that happen? Sometimes it combines both. All these are fine and have quite well-established and sensible ways of selecting a solution.

The hardest questions are those where all you can do is show the other person, how to work out their own answer simply because the answer is different for everyone. There's one such question which always falls into this difficult category: How do I achieve 'financial freedom'? At first, this looks like a vague term even though it signifies a roughly similar thing to almost everyone: Financial freedom means not having to worry about money ever, and knowing this with a high degree of confidence.

This is probably always the dream of most people but it seems to have become more common to articulate it. Since the daily grind of earning money dominates our lives, a permanent relief from this is the freedom that most of us desire. Of course, there are many degrees of financial freedom, and the ultimate one is not having to work to earn money for the rest of one's life. Of course, there are many who do not have to work. There are those with large inheritances, and there are those whose burden we taxpayers are committed to carry all our lives, but it takes most of us an entire working life to reach that stage. If at all we ever reach it.

Financial freedom means not having to worry about money ever, and knowing this with a high degree of confidence

However, it's worth it to clearly articulate what different levels of financial freedom mean. Based on what many authors have written, here's one list that you will often come across if you start searching on the internet. This one is based on the one in Grant Sabatier's book Financial Freedom: A Proven Path to All the Money You'll Ever Need.

Seven levels of financial freedom

1.Clarity: When you have understood your financial position and what you can achieve.
2.Self-sufficiency: When you earn enough money to cover your expenses on your own.
3.Breathing room: When you escape living from salary to salary.
4.Stability: When you have six months of living expenses paid and have no consumer debt.
5.Flexibility: When you have at least two years of living expenses saved.
6.Financial independence: When you can live off your investment income, and therefore, working is optional.
7.Abundant wealth: When you'll have more money than you'll ever need.

Clearly, there is a little bit of padding here, just to reach the number seven. However, as you read through the levels you will very likely agree at the general progression of the idea. Moreover, the first step - which is all about understanding and introspection is actually very important. As we read through the list, few of us will think realistically of reaching the highest levels, but that does not mean that thinking about financial freedom systematically is useless.

The simple fact is that if we save and invest with a modicum of planning, lesser degrees of financial freedom can be achieved earlier in life, and that can be just as good as achieving higher levels later. Moreover, as the Indian economy has changed, this has become more important. India is clearly passing through a jobs crisis. There are a number of people in the urban middle-class who have suddenly lost their jobs. Youngsters are finding their first jobs difficult to find, or have to take low-quality employment. Middle-level executives are being shunted out of their employment because employers think they can be replaced at a lower cost.

For salary-earners, getting even a mild form of financial freedom early in life is more important now than it was a decade or two ago. If one can reach level four by the age of 35 or level five by 40, that's a great thing to achieve. I'm not going into the mechanics of doing this - that's what I do most of the time - but I'm simply pointing out the great value in thinking about this systematically, setting a target, and working towards it.