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There is a substantial risk of loss associated with trading Derivatives . Losses can and will occur. My methods will not ensure profits

Friday, August 31, 2012

Fundamental Flaws

I started my Stock Market investing in late eighties. I used to submit multiple applications for good primary issues and made good money. Later CCI was abolished and companies started charging premium on their issues. So there was no way to make profit but to go for secondary market investments. Trading was really not an option as there was no internet and electronic trading.

Like any other investor, I used tools like PE ratio, PB ratio, EPS etc for my analysis. I compared the company PE ratio with the Market, Sector, Industry and the historic PE of the same company. Lost a lot of money, energy and time after buying an undervalued stock and waiting for the market to discover the value.

One fine morning, it dawned on me that I must focus on Market price and not on these ratios. So I changed the formula. $PE\ Ratio = \frac{Market\ Price}{Earnings\ per\ share}$ to $MP = EPS * PE\ Ratio$. So the Market price is a multiple of EPS and a variable. This variable is nothing but the market sentiment. Our companies declare their results quarterly and this EPS remained a constant at least for a quarter. Then everything was clear, the focus should be on the sentiment rather than on earnings for the short term player.

People may argue that projected EPS is more important and we may need to research and pick stocks. So far I could not accurately project not even the profit of the bank branch, where I work, for any quarter even though nothing happens there without my knowledge. Leave alone thousands of companies operating in different sectors, industries and geographical regions.

If you do not have a lot of luck or right connections to get inside information, chances of becoming a successful investor is very remote. Buying lottery tickets can be a better option.

"Fundamentalism" can be injurious to your financial health.

Posted by SMART Trader at 5:37 PM



10 comments:



Ramesh Ramachandran August 31, 2012 at 6:03 PM

To succeed as an investor one needs to invest when all asset classes are down. When you feel deep fear to buy any stock as a stock price falls 10% in a day becomes usual. And sell when you will find that companies with no value are floating IPOs at high premium and they are hugely oversubscribed.

Reply



VK August 31, 2012 at 11:39 PM

Hi ST:

Nice article on Fundamentalism. Technically speaking, all fundas are mental in nature. The term is a misnomer totally.

Reply

Anonymous September 1, 2012 at 7:24 PM

Warren Buffet said if companies are doing good the price will follow it. Is he wrong? Can we use TA for long term investment?

Reply



SMART Trader September 1, 2012 at 10:00 PM

Anon

We do not need Warren Buffet to know earnings drive stock prices. Fundamentals do work no doubt. But research based on publicly available information is not going to give you an edge. Investments based on cooked up accounts and planted news reports are dangerous. You thought Mr. Jhunjhunwala is making his investment decisions reading Economic Times and Dalal Street Journal? Company promoters will approach him with investment proposals. He is a kind of venture capital provider. Mr. Buffet is not different.

For investment, better buy real estate where there is population influx. You will always do better.

ST

Reply



Ananth September 2, 2012 at 7:51 AM

hmm....good old days when all (almost) scrips had their face value at Rs.10 and all IPOs had to be issued at the face value.....days of deception began when they allowed face value to be anything (misleading most people) and IPOs to be issued at exorbitantly bloated price in the name of book building.....you can argue about technicals vs fundamentals till the end of time and still be where you began.....i for one rely on technicals in my trading (mostly nifty futures and options)and contrary to popular wisdom i have been a practitioner of buying on dips and cost averaging downwards...over the years it has given me quite a lot of profits in scrips like acc/telco/tisco/infy/itc/hll

Reply



Raghu R Bhat September 2, 2012 at 8:20 AM

WB lays the greatest emphasis on management honesty and quality. No wonder he could not find a single company to invest in India (He does not invest in IT, so Infosys is out). The right place for 95% of Indian promoters is jail. Trading is way better than reading jackass Annual reports and discussing fundamentals.

rb

Reply

Anonymous September 2, 2012 at 10:05 AM

"All markets are designed specifically for THE CUSTOMER TO LOSE"

This is the reality.

All markets: Fish market, Grocery market, Veg market, property market, share market, EVEN A DISCOUNT MARKET, etc etc. Whichever market u approach as a customer, YOU R AT THE LOSING END!!!

IF U CAN BEAT THE DESIGN OR MAKE UR WAY AROUND THE DESIGN OR FALL IN LINE WITH THE DESIGN AND MAKE THE BEST OF ITU SURVIVE....

ELSE ONE IS CONDEMNED TO A LIFE OF MEDIOCRITY!!!!

Reply



Raghu R Bhat September 2, 2012 at 9:55 PM

"All markets are designed specifically for THE CUSTOMER TO LOSE"

This is an assertion and not an argument. Markets have a willing buyer and seller, and both are satisfied by the process. Equities are a Giffen good - and satisfy no physical human need (except greed) and cannot be compared with other transactions. For all practical purposes buying and selling is just a game - with assymetric information. When you notice how easy it is to rig this game that you worry.

rb

Reply



Naren Lokwani September 6, 2012 at 9:05 PM

Dear Sir,

Sorry to say, your assertion on Fundamental analysis is totally wrong.

One can create (and lose) wealth only on the basis of Deep Value investing. Technical analysis done at home, would only provide you scratch trades for few (thousand) rupees, hence is a waste of time.

TA and algos used by Hedge funds result in billions of profit (and loss).

For ordinary chap, find deep value firms and invest for long term

Warm Regards,
StockFandoo

Reply



SMART Trader September 6, 2012 at 10:10 PM

Stock Fandoo

Thanks for the comment

I trade for income and a few thousand Rupees a day is enough for me.

For wealth creation , I will prefer investing in land.

Wealth creation is possible with Deep value investing. If only you are lucky to pick the right stock and hold it for a long time.


IMHO, momentum investing is a better option. Identify sector rotation at an early stage and stay with it as long as it moves.

ST

Reply

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