Chapter 7

Do's and Don'ts to Avoid Loss in the Stock Market

7.1 Don't Check the Daily Stock Price Quote –

With the advent of the internet and smartphone, the stock price quote is always available at our fingertips. It is quite common that an investor goes through the live stock price quote twice or thrice daily. An instant happiness follows if the invested stocks are in green while the opposite happens if those are in the red! Following example will clear you how too much focus on daily price movement can negatively affect you.

During May 2013 I had suggested Can Fin Homes. One of the members, Ramesh (Name Changed) purchased the same at ₹150 (price not adjusted with bonus/split). He was quite confident regarding the prospects of the housing finance industry. The company mainly disburse housing loan to salaried individuals among tier II and tier III cities. Due to strict lending practice, they had zero Non-Performing Assets (NPA). Everything was fine. However, the stock price didn't move at all for the next 4-5 months. It dipped around ₹115 during August 2013. Ramesh continued to follow the stock price regularly. Once he had full confidence in the stock but the underperformance of 4-5 months made him doubtful. Finally, he sold his entire investment during October 2013 at ₹145. He was happy with the fact that he didn't have to suffer any significant loss. He sold it at ₹5 loss per stock.

Within ten months from his selling, the stock price zoomed into ₹420- ₹460 level. Thus, almost three times return within ten months! At this junction, Ramesh had nothing to do. So, what went wrong with him? Although he was highly confident about the business and prospects of the company, still he didn't have enough guts to experience a short term downfall. The stock moved from ₹150 to ₹115, and his entire conviction disappeared. At ₹115, he was thinking to exit somehow at minimum loss. So, while the price bounced back near ₹145, he sold the entire holding. Later the same stock generated three times (200%) return within ten months. Thus his early conviction on the business proved correct. He could avoid this situation if he didn't follow the stock price regularly.

Another client, Rohit (name changed) was fortunate enough to enter around ₹115 - ₹140 during July-August, 2013. He invested in parts, and average purchase rate was around ₹125. Rohit too was convinced with the future business prospects. Unlike, Ramesh he patiently held the stock during the correction period. His patience paid off. Within April 2014 his investment generated 100% return. The stock price was hovering around ₹250. However, 100% return within nine months made him tensed. He checked the fundamentals and found the same was improving. Most importantly, even after 100% return the valuation was still cheap. Rohit too used to verify the stock price twice or thrice daily. From the recent peak of ₹250, while the stock corrected around ₹230, he was worried regarding the fact that after 100% return within nine months, it may correct more. He sold his entire stake at ₹250 and planned to re-enter around ₹200. He was happy with the fact that he already bagged 100% return within nine months. The stock never corrected to ₹200, rather within next one month it crossed ₹300 level. At ₹300, Rohit had planned to re-enter around ₹250, as he sold his entire stake at ₹250, so it was difficult for him to re-enter above ₹250. The stock didn't correct at all; further, it crossed ₹400 within next month. By October 2014, the stock price was hovering around ₹450. Instead of checking live stock quote 2-3 times daily, if he had only concentrated on the business progress, management interview, and quarterly result, then today he would have 200% return.

To sum up, checking stock price frequently can affect your investment in the following ways –

1. Early profit booking – Fear of losing money always exceeds the excitement of gaining big. Frequent price checking may force you to book small profit from high-quality stocks that can multiply your investment over the long run.
2. Premature exit – We, the human beings are full of emotions. It is very difficult to accept the monetary loss. Irrespective of the fundamentals, if a stock didn't move at all over 8-10 months or if it remained below our invested price, then it is hard to hold the conviction. In such situation, frequent price checking can lead to the premature exit. (Refer to the first example of Can Fin Homes)

Don’t bother about short-term price movement. Over the short run, the quality stock can move either in upward or downward direction, but over the long term, it can move only in an upward direction. As an investor, you need to follow your investment regularly. Following investment doesn’t mean to follow the live price quote. You need to act like a business owner. Keep a close watch on business/industry related news, quarterly result and management interview, and that’s enough.

Legendary investor, Warren Buffet, once mentioned, “If you can’t hold a stock for the next ten years then don’t buy it for the next 10 minutes.” Always, remember over short run a stock price can go up/down by 10%-30% without any reason. Don’t take your investment decision based on short-term price movement. It will be better if you can stop following daily live stock price quote.

> *“Over short-run, stock price of the best managed company can move either upward or downward direction, but over long run it can move only in single (upward) direction.”*

While checking daily price movement maximum investor also computes unrealised gain/loss in his overall portfolio. With the advent of Portfolio Trackers, it is easy to find out the overall profit/loss in the portfolio at any particular day/moment. One of the most important lessons that I learned from my journey is that ***“Never ever calculate profit/loss until you are selling a stock.”*** Remember, unless you are selling, the entire profit/loss belongs to the market! It is not yours. The unrealised gain in the portfolio brings a pleasant happiness while unrealized loss depressed us. However, neither helps for becoming a better investor. We, the human beings are full of emotion. Even unrealised loss (even if you know it is not real) affects us for rational decision making. Maximum investors can’t utilise bear market (falling rate to buy more) because of the unrealized loss that paralyses logical thinking. However, the same investor will shop more if a departmental clothing/grocery store offers 30% discount! Similarly, during the strong bull run (price moving up daily), maximum investors keep heavily increasing the investment because of the pleasant feeling from unrealized gain. Perhaps, the stock market is the only place in the world where buyers shop less during the discount session and prefer buying more at the higher rates! You can prevent such illogical behaviour only if you stop calculating profit/loss until you sell the stock.

7.2 Don’t Emphasise on the Purchase Rate -

During 2011, I had purchased HCL Technologies at around Rs-500 due to improved fundamentals and revival of Information Technology sector. I was then in my 2nd year of my four years Bachelors degree. I didn’t have enough money to invest. Moreover, the fear of losing ₹1000 exceeded the joy of earning ₹2000. I used to check the current market price (CMP) on a regular basis. I was quite confident that my purchase decision was right as long as the stock traded above 500. Soon after three months the stock price started falling and reached around Rs 400 within six months from my investment. I was so anxious that I began to find out exactly where I was wrong but didn’t find enough reason. The company reported excellent numbers quarter after quarter as I was expecting still the stock price was lagging behind. I used to check stock price almost 2-3 times a day just to check whether any improvement in stock price is happening or not. Checking stock price 2-3 times in a day is a clear indication that the investor is moving out of fundamentals and too much concerned with his purchased rate and current market price. During the next few months, the stock price started recovering and slowly reached around 450. At this junction, I was happy that my loss is recovering slowly. Every day I used to calculate my notional loss. Finally, I sold my entire holdings at around Rs-450. I was happy then as I narrowed down my loss. **My happiness didn’t last long as I noticed that after my selling, the stock price appreciated to Rs-1500 within the next two years!!** So, I picked the right stock at the right time, but I was failed to earn three times return. This is a classic example how I missed three times return just for focusing too much on current market price. I failed to consider my investment as a partial ownership in that company, and market taught me a great lesson.

Lessons Learnt-

Having the knowledge and applying that in real time is entirely different. I was well informed that *a stock is nothing but a partial ownership in the underlying business*, but still I failed to implement it in real life. If I had focused only on company fundamentals and financials, then I should have ended up with three times return. Instead, I was too much concerned with my purchase rate and current market price. Symptoms like checking stock price 2-3 times daily indicate that you are not considering your stock investment as "*partial ownership of that business*". Any business owner (like grocery owner or restaurant owner) should always concern on their business to maximise earning. Are they concerned the current market value of their stores? So, being a partial owner, why are you too much focused on the current market price rather than the underlying business?

How I missed maximising profits due to too much focus on purchase rate:-

During December 2012 I had invested in Ajanta Pharma at around Rs-250. (Split and bonus adjusted price will be 100) The rationale was cheap valuation, huge growth prospects, and great balance sheet. I was highly convinced by the story and eager to increase my position later. Within two months from my investment, the stock price jumped around Rs-440 level due to better than expected quarterly result and excellent prospects. Within two months, I was in 75% profit. At this junction, I was unable to "buy more" shares of Ajanta Pharma only because of focusing too much on purchase rate. On the chapter titled "When to Buy and when to sell?" I had mentioned in details how I missed the chance of maximising profit in Ajanta Pharma. If I didn't put too much focus on purchase rate, then I could have avoided the situation.

> *"Too much focus on purchase rate can reduce the chances of profit maximization."*

7.3 Don't Try Predicting the Market Direction –

We invest in particular stocks (companies). None of us invests in the market (Sensex/Nifty). Surprisingly, you will find 99% investors are more interested to know the overall market movement. They are more curious to know whether the market will move up or down. I too receive many such queries from our clients. Like-

"How long the market will continue its up move?"

"Do you think the market will crash shortly?"

"What's your near-term outlook on the market?"

"What's your near-term Sensex target?"

Surprisingly, those queries are not coming from day-traders; rather those are coming from investors. They are less interested to know the fundamentals of their holding stocks, but while it comes to Sensex movement, they become the most interested one.

Remember, you are not investing in Sensex; you are investing in particular companies. Your portfolio return is entirely dependent on the business outlook of that particular business; not on the Sensex movement.

Now, you may tell me that if over a period Sensex appreciates 20% then my invested company is also bound to generate a positive return. Similarly, during the market crash, my portfolio is bound to produce a negative return. Consider the following examples –

1. During 2011, Sensex generated a negative return while during the same period Page Industries generated 80% return. Not only Page Industries, throughout the entire 2011 various FMCG and Pharma stocks produced more than 50% return against the negative return of Sensex.
2. If we consider well-known large-cap stocks those are part of Sensex, then also we will find such variation. FMCG major ITC generated around 20% return during 2011 while Sensex generated a negative return.
3. During 2010-2012 Sensex remained range bound. During the same period stocks like Page Industries, Kaveri Seeds, La Opala Rg, etc. generated more than double return.

Above examples suggest that an investor can earn money even during a bear market (although a bit difficult) if he invests in the right company at the right time. Conversely one can lose money even during the bull market. Large cap well-known stocks like DLF, Unitech, Suzlon, etc. are prime examples.

It does not matter whether the market is going up or down. If you invest in strong business having bright future outlook, then you are bound to generate a positive return over the long run. Similarly, even during strong bull-run if you invest in low-quality stock, you will end up with a negative return. As an investor, your only task is to select great companies and invest at the right time. Following the prediction of the overall market movement is wastage of your time and energy. Keep your focus only on company specific events. Have a closer look at the business model, the financial numbers, and the future outlook of the company. Return from any particular stocks doesn't depend on Sensex movement. Stop following analysts those are coming up with new Sensex target on a regular basis. Remember at the end of the day; it is the underlying business that matters most.

7.4 Love Bear (Falling) Market -

Retail investors prefer to buy stocks while they are moving up or while the overall market is in the bullish situation. Market prediction also moves along with the market direction. While the market is moving up you will find bullish stance over the business channel, newspapers, internet, etc. and if the market corrects just after few days, you will notice just opposite viewpoint on the same medium. This is why retail (small) investors always prefer to invest while the market is moving up and prefer to get out from stocks during a market correction. In this process, they end up with buying at high and selling at low.

All of you are well aware of the fact that successful investing requires buying at low and selling at high. However, very few investors implement this principle in real life. To implement the same practically, you need to love bear market or while the market is falling. “Greed” and “Fear” are two primary obstacles. During market correction, fear of losing money prevents to take any rational decision. You need to control “fear” while everyone else is selling. History says no one can suffer loss investing in the bear market. If a person invested during October 2008 – March 2009 or during 2002-03, he can't suffer loss from his investment. Here we assume that the individual is holding his position for at least next two years.

Investment opportunity in the prolonged bear market doesn't come frequently. Once or twice in 10 years, such golden opportunity arrives. Even investment in mediocre companies during such period generates 100%+ return over next 1-2 years! Stock selection also becomes easier because most of the companies during those periods are available at throwaway valuation. So, don't miss any such future opportunity.

Now, another question may arise, "How to figure out such golden opportunity?" It's simple. Market correction of more than 50% compared to recent peak brings such golden opportunity. It is also easy to identify as during those period market is filled with maximum pessimism.

> *"In 95% cases investment during bear market yields positive result. (Provided you hold the same for next 1-2 years)"*

POINTS TO REMEMBER

- Over short run stock price of the best managed company can drop down without any reason. However over the long run stock price of fundamentally strong companies can move only in upward direction.
- Don’t follow stock price quotes twice or thrice in a day. It creates unnecessary panic and sometimes meaningless delight.
- Don’t focus on Index (Sensex or Nifty) movement. Don’t try to predict near term Sensex or Nifty movement. You are not investing in Sensex; rather you are investing in individual stocks.
- Considering the minimum holding period of 1 year, Investors can’t suffer loss investing in deep bear market.

Chapter 8