Chapter – 2
Stock Market is Not Risky at All

2.1 Introduction

Maximum investors prefer to keep their savings in the bank rather than investing in stock market. The only reason is "risk". A few days back I was having a conversation with one of my friends, and he mentioned, "Keeping money in the bank account at least assures that it won't lose value, while in the stock market there is no such assurance." Bank offers a steady return on investment; on the contrary, return from stocks is uncertain. ***Well, What if I mention keeping money in a bank account is riskier?*** I am sure many of you will be surprised with this statement. Now let me tell you about a silent killer named "inflation". Fixed deposit in banks will surely offer 7%-8% annual interest but do you ever consider this in conjunction with inflation and tax? In simple language, inflation is the increase in price you pay for goods. Today if your monthly grocery bill stands at ₹5,000 then certainly over the next one year it will increase. You can also refer it to a decline in the purchasing power of your money. Like if 1kg mustard oil costs ₹100 today then after one year you can't purchase the same quantity at ₹100. So, today's 100 rupees is no more worth the same after one year. As per the government data, the average inflation rate in India is hovering around 7% for the last few years. I think in reality if we consider our day-to-day expenses then inflation will be higher than the Government data.

So, 100 rupees investment in bank fixed deposit turns at around 107-108 after one year, but it costs 110 rupees to cover-up the same daily expenses. Isn't the bank's fixed deposit yielding negative return? The situation will worsen if you consider tax. Interest income on bank's fixed deposit is fully taxable. Depending upon your taxable income, the tax rate varies. For the person in the highest tax bracket, it is as high as 30.9%! Even if you are in the lowest tax bracket, then you need to shell out around 10% tax on the interest income from bank's fixed deposit. If you combine tax with inflation, then bank's fixed deposit will offer a negative return. Ten lakhs investment in bank's fixed deposit will become 7.48 lakhs only (after one year) considering 8.5% interest, 9% inflation and 30.9% tax (highest bracket). For individuals in the lowest tax bracket, it offers a marginal negative return. The irony is interest on the fixed deposit is indirectly related to inflation. ***Thus in conjunction with tax and inflation, fixed deposit can't offer a positive return.*** Still, you want to say that the fixed deposit is one of the safest investment bet? The saddest part is that more than 50% household savings in India are in the form of fixed deposit. You may state that investing in the fixed deposit is for diversification. Well, many tax-efficient debt investment options are there which offers steady return and also serve the purpose of diversification. The problem is many of us are not aware at all.

2.2 The One and Only Risk in the Stock Market

Investing in stocks is similar to that of driving a car. From the beginning, nobody is an expert in driving. You need to learn driving. If you skip the learning portion and take steering on the very first day, what will be the consequences? The accident is almost certain. You can escape from the accident but in that case, you are just lucky. Similarly, without any knowledge, you are bound to lose money in stock market. You can earn on few occasions, but that's just because of your luck. To earn consistently, you must have in-depth knowledge. To avoid any accident, an experienced driver also needs to drive carefully. Similarly, experienced investors should also remain cautious about his investment decisions (and emotions) to avoid loss. Chances of accident can be minimized if you follow certain driving rules, similarly by following certain disciplines you can minimize the chances of losing money in the stock market. Driving doesn't require any formal educational degree. It is not like that only mechanical engineers, or those who have in-depth knowledge of motor mechanics can only learn driving. Irrespective of the degree, anyone can learn driving. Similarly, an MBA in finance or similar degree can't ensure success in equity investing. Rather, I think without an MBA one can become a better investor. Irrespective of educational background and specialization, anyone can learn the tactics of successful investing. It's simple but not easy. "Simple" in the sense that it doesn’t require high intellectual. “Not easy” because it requires years of practice, discipline, dedication and willingness to learn.

Avoiding equity investment means you are most likely unable to beat inflation. Banks and post office deposit offer negative or flat return (inflation and tax adjusted). Very few investment options (like real estate and equities) can offer above inflation return. Over the last many decades, across the world, among all asset classes, equities have outperformed all others over the long run. So, isn’t “zero exposure” in equities a sheer negligence? Are you not taking a big risk by avoiding equity investment?

“Avoiding investment in equities is risky: very

2.3 The Only Way for Wealth Creation

Historically it is proved that only stock market and real estate investment can offer an above-inflation return in the long run. Real estate requires big-ticket investment. Thus the market is not accessible for small investors. For salaried individuals and other professionals, the stock market is the only way for wealth creation. Avoiding equity investment means your retirement life is at risk. Among real estate and stock market, the latter should be the preferred choice for every individual due to the following reasons-

1. You can start investment in equities with as low as ₹5,000. However, in real-estate, you can’t go with such a tiny amount. For any retail (small) investor equity investment is much more convenient.
2. The stock market is highly regulated. Thus, price discovery is much more transparent. Market regulator (SEBI) has taken almost all steps to safeguard the interest of small investors. However in real estate, price discovery itself is not so transparent.
3. Equity investing offers higher liquidity than real estate. You can purchase stocks anytime and also sell them after few moments of purchase. There is no obligation. You can sell it after 1 minute or 1 month or 1 year or 10 years whenever you want. However, in real

estate, you can’t purchase a land to sell it on the very next day.

4. You can buy and sell stocks from anywhere in the world. With the advent of online trading, physical presence is not necessary. Buying and selling can be done with just a click of a mouse. However, in real estate, investment is not that simple.

Because of many such advantages and above-inflation return, equities must be the part of everyone’s portfolio. The irony is that retail participation is lowest in Indian stock market compared to other countries. Widespread misconception and lack of knowledge are the main reasons.

A few years back I had a telephonic conversation with a first-time equity investor. Following is the transcript of our conversation. From this incident, you can easily guess why small investors avoid stock market-

Investor: -Just a few days back I came across to your website and got the details of your equity advisory service. How much return can I expect following your stock recommendations?

Me – You can expect around 20%-30% average annualized return over the long term.

Investor- Only 20%-30% annualized return!

Me – Why? Isn’t 20%-30% sufficient for you?

Investor –Basically, others are offering 30%-60% monthly return, and you are saying just 25%; that too annualized!

Me – Monthly 30%-60%!! Well, why don’t they trade on their own? Frankly speaking, for me, 25% annualized return is sufficient enough.

Investor – Right now, the market is in the upward direction, and I want to make the most of this situation so I can’t consider you as my preferred choice.

Me – Well, My advice is to stay away from any anyone offering such extraordinary 30%-60% monthly return.

Investor – Sorry to bother you. For me, 25% annualized return is too little to consider the stock market. I can’t go with you.

Me – Fine, not an issue. Make sure to inform after 6-8 months regarding your progress in equity investment.

Just after three months, the same person called back to mention that he lost ₹2 lakhs from trading just because of the individual who promised 30%-60% monthly return. I wasn't surprised at all rather I congratulated him because he learned the lesson within three months at the cost of 2 lakhs.

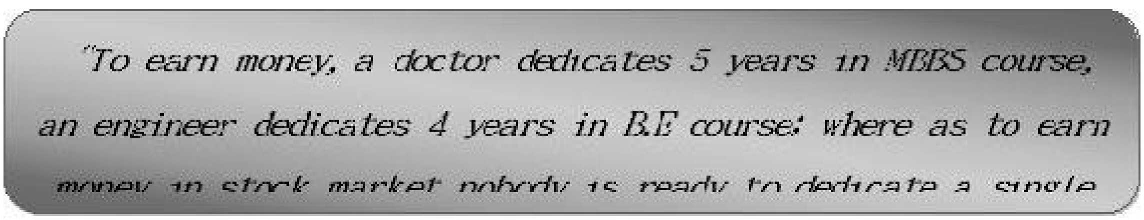
Now, I have a question for all, from the above incident, whom do you want to blame? Many will blame that advisor; many will blame the stock market itself! Very few may get ready to blame that investor. But in reality, it is that investor, who is alone responsible for the outcome.

Investors are satisfied with 7%-8% interest on bank's fixed deposit investment. However, the same person is not happy with 25% annualized return from the stock market! More than double return that of bank deposit or post office deposit. Still, they demand more return from stocks! For me, 20%-30% annualized return from the stock market is sufficient, anything above that is a bonus. During the bull market, you may earn much more return, but that's not permanent and can't be repeated year after year. Over a period of 15-25 years if your average annualized return remains within 20%-30% then you can easily achieve financial freedom. Always remember world's most successful billionaire investor and also once world's 2nd richest person, Warren Buffett made his fortune by just 22% annualized return over 50+ years. On the contrary, many amateur investors demand 30%-50% monthly return, jump in the stock market; end-up with loss and finally blame the market itself! Sometimes they even mention that equity is another form of "gambling" and also restrict others from investing in stocks! Hardly, they dig deeper to find out their own mistake.

> "Investors gladly accept 7%-9% annual return from bank's fixed deposit but the same person can't accept 25% annualized

2.4 Don't Skip the Basics

Lack of proper knowledge is one of the primary reasons for widespread misconception in the Stock market. Just think of it, completing our formal education requires around 12 years. From nursery to higher secondary level – the journey is quite challenging. Post higher secondary level, we choose our career path. To complete graduation and post graduation, it requires another 4-8 years. After the rigorous 18-20 years of hard work and dedication, we finally land up with a job for earning. Whether you are self-employed or salaried professional, you must have to go through the 18-20 years of the learning curve. Every single penny of your earning is the result of those 18-20 years of hard work. But the surprising fact is that in the stock market, investors attempt to earn from the day one itself! Doctors dedicate five years in MBBS course and then few more years in practicing. Finally, they are capable of making from the profession. However, in the stock market, the same person attempts earning money from the first day! If you are not well-equipped with knowledge and expertise and still going for a critical medical operation, then what will be the consequences? Whom to blame for such consequences? Unfortunately, in the stock market, investors jump with little or no knowledge, end up with loss and then blame the market! Excluding themselves, investors are ready to blame everyone. Isn’t it ridiculous? Isn’t it like expecting crops without sowing the seeds?



2.5 Investment in Knowledge Pays the Best Interest

A stock is nothing but a partial ownership in the business. Consider yourself as an owner of the local restaurant. As an owner can you consider buying and selling your restaurant frequently? If your business will face a temporary downturn, do you consider selling and then buy back again while good time returns? Surprisingly in the stock market, investors are ready to trade frequently. A mere 10% rise in stock price tempts to book profit while 10% drop in stock price creates panic. The more you trade the chances of losing money will widen.

If you can consider yourself as a partial owner of the business, then you can restrict yourself from frequent trading.

Before purchasing cars, expensive mobiles or television, we undergo rigorous research. I still remember, before purchasing my first car I had spent minimum 30-40 hours on the internet over 3 months, three times showroom visit and then continuous monitoring of car price trend. After that, I took a test drive with another friend, consulted with my family members and then purchased the car. While purchasing a stock do you conduct such rigorous research? Not only car, just consider your last purchase of any expensive electronic gadget. All of us try to collect maximum data from our friends, the internet, and other sources and then take our decision accordingly. But, do you spend a fraction of that time before equity investment? If investors can dedicate the same amount of time before purchasing a stock, then I would not have considered writing this book!

Before jumping into the stock market, you need to sharpen your knowledge of the stock market. This book is dedicated for this purpose. From the next chapter onwards you can learn various aspects of equity investing in easy-to-understand language with lots of real-life examples. As mentioned earlier, it is simple but not easy. More than “what to do” you need to learn “what NOT to do”. From the previous chapter and this one, I hope you have got an idea of “what NOT to do”. To conclude this chapter, I want to mention that you have already taken the first step towards “How to avoid loss and earn consistently from Stock Market”. Move ahead to the next chapters; I can assure equity investing will become much easier, simpler and rewarding more than ever.

“Investment in knowledge pays the best interest.” – Benjamin

Points to remember

- Equity investing is not risky rather staying away from equity investment is risky.

- After adjusting tax and inflation, bank's fixed deposit yield a negative return.
- Equity investment is the most convenient option for long-term wealth creation.
- Investment in stocks is just like driving a car. If you can master the subject, it becomes easier.
- Lack of knowledge is the primary reason for widespread misconception and lowest retail participants in the stock market.
- A stock is nothing but a partial ownership in the business. Treat yourself as an owner of the business.
- Before considering equity investment, invest in knowledge. Investment in knowledge pays the best interest.

Chapter – 3

First Step of Picking Winning Stocks

3.1 Where to Start?

Suppose your friend advised you to invest in ABC Limited or an equity analyst is recommending a particular stock. Before investing, you are eager to judge some basic parameters. However, you are confused. Starting from balance sheet ratios to valuation ratios, there are hundreds of such parameters. Which one to consider first? What should be the priority order? Many investors start with profit growth numbers. You will commit a big mistake if you begin with profit growth and put too much focus on it. Any company can easily manipulate profit numbers. Further big profit doesn't ensure real cash flow. A company may report