Chapter 9

Is it Required to Follow an Equity Advisor?

9.1 Introduction –

Once an HNI (High Net Worth Individual) told me, “I am ready to pay for offering me the name of a reliable equity advisor”. This single statement is sufficient enough to describe the scarcity of reliable and trustworthy investment advisor. With the advent of the internet, the situation turned worst. You will find thousands of self-claimed experts over Facebook and Whatsapp group! Even, anyone can set-up a professional looking website to offer stock tips. It is easier to showcase false past performance, fake client’s testimony, etc. and almost impossible to check the truth. With so many advisors here and there, it is really difficult to separate the wheat from the chaff. You can be easily trapped. Once you burnt your finger and ready to spread the world, you may find that the website is closed down. The same person (or entity) may operate from a new website changing their name and repeating the process. Retail investors suffer the most from this process. They lose their hard-earned money and end up with disappointment.

Further, with the plenty of stock tips over the internet it is challenging to decide whom to follow and whom to not. Before proceeding further let’s have a quick look on the fact that “Do you require an equity advisor?”

9.2 Do You Really Require an Equity Advisor?

In school, we all studied around 8-10 subjects. During my engineering course, there were six subjects in each semester. We had total eight semesters, so in total 48 subjects. Out of those 48 subjects, there were 10-15 subjects just to fill up the curriculum! Still today, I try to find out the practical implications of those subjects in our real life. You may differ with me on this subject but to be frank, I believe traditional education system has very little significance in our practical life. At best, it can only help you to secure a job, nothing else. From childhood to college days, there are so many subjects but surprisingly one of the most important subjects, “Personal Finance” is missing from the entire curriculum. Whatever be our profession, we all earn money, spend it and save for future. We all need to manage money so “Money Management” should be one of the compulsory subjects but surprisingly it is missing from our entire curriculum. This is the only reason why so many people in spite of earning big are struggling with their financials. Many salaried individuals are in huge debt burden and struggling to get out from it.

We can’t expect “Basics of Stock Market” from the curriculum where “Personal Finance” is missing. I think this is another reason why 80% investors suffer loss in the stock market. Our traditional education system doesn’t encourage learning about money and investment. Indian parents are not comfortable enough to discuss the topic “Money” with their kids. However, in real life, we all are “Money managers” managing our personal finance! Investing in the stock market without having basic knowledge is just like sending an amateur driver for driving down the hilly road. In that logic, you require a reliable equity advisor to invest in stock market. However, if you can dedicate good amount of time, then you can also learn the basics on your own. Based on availability of time, you will come under any of the following the three categories-

Category A –

If you can dedicate more than 3 hours per day or more than 20-22 hours per week in equity analysis, then you can master the subject by yourself over 3-5 years period. No need to go for any equity advisor or mutual fund investment. You can go for direct equity investment but make sure to dedicate at least 3 hours per day for five continuous years because learning is an ongoing process. The day you stop learning, your investment will be at risk. Initially, start investing with a small amount. You have to go through many trial and error processes. Mistakes will happen but make sure not to repeat the mistakes. Be ready to lose money during the journey but consider the loss as “fees for learning”. Write down your every mistake and figure out what you can learn from it. Continue the process for minimum five years; you can master the art.

Category B –

If you can dedicate only 1-2 hours per day, then you should go for equity advisor, but don't follow your advisor blindly. Check out whether he can provide enough rationale against his stock pick. Mutual fund investment is not advisable for you as direct equity investment with proper guidance will fetch better return across any market situation. After getting any investment idea, cross checks the basic parameters those are mentioned in this book. 1-2 hours per day or 7-14 hours per week is sufficient enough to cross check the basics like ROE, debt level, growth numbers, shareholding pattern, etc. After the investment, don't forget to monitor the stock on a continuous basis. Monitoring doesn't mean just to check the daily stock price. It refers checking management interview, company or industry related news, latest happenings and quarterly results.

Category C-

If you are too busy with your full-time job or can't dedicate a single hour per day on equity analysis or if the subject seems too boring then you have two options. Either go for reliable and trustworthy equity advisor or go for mutual fund investment. With proper guidance, direct equity is far more beneficial and rewarding than a mutual fund. If a person manages an individual portfolio and at the same time manage a mutual fund, then his individual portfolio will outperform the mutual fund across any market situation. In the latter part of this chapter, I will provide a detailed rationale for this phenomenon. So, your priority should be to for direct equity with proper guidance. Don't do it on your own because direct equity investment requires discipline, patience and above all wide application of knowledge. Acting upon on free tips from here and there, frequent trading on broker's advice can cause severe loss. It's your hard earned money, utilise it carefully. If you are unable to figure out reliable equity advisory, then stay with a mutual fund. However, you need to select a proper mutual fund based on your requirement. There are hundreds of mutual funds in the market so choose carefully.

9.3 Mutual Fund or Direct Equity Investment

One of my clients once suggested the following –

"Your portfolio performance is much better than the best performing mutual fund in India. Why don't you set-up your own fund house or become fund manager of any existing mutual fund? It will be beneficial for more small investors."

The answer is I am not more intelligent than fund managers. Mutual funds are structured in such a fashion that it brings down annualised return to balance risk-reward ratio. As an individual investor, I can invest in any microcap or small cap stocks but mutual fund can't. I can hold any stock as long as I wish but mutual fund can't. I can invest 25% of my total holdings on a single high conviction stock but a mutual fund can't. So, if I manage my own individual portfolio on one side and a mutual fund on another side, then it is obvious that my individual portfolio will outperform.

Moreover, fund managers have too many restrictions and regulations to follow. During August 2013 banking sector suffered drastic fall mainly due to rupee depreciation and liquidity tightening measures by RBI. Market downfall due to macroeconomic reason offers great buying opportunity provided the fundamentals remain intact. Quality banking stocks like ICICI Bank, HDFC Bank, Axis Bank, etc. were trading at lowest valuation range. During that period, I had a conversation with a mutual fund manager. He agreed with the attractive buying opportunity. However, his fund didn't go for fresh investment on banking stocks. I was surprised and asked the reason. He mentioned that as a salaried fund manager, he was more concerned to keep his job. If the slowdown continued for a prolonged period, then his mutual fund will underperform than peers, and he can be fired. It is much easier to go with the tide (market crowd). If you move with the tide and prove wrong, then there will be many to share the blame, but if you move against the tide (general market perception) and prove wrong, then all fingers will raise against you. This is the reason why mutual funds always offer average return; their target is to beat the index by any margin almost on a regular basis! If you want to earn great return, then you need to buy while everyone is selling and need to sell while everyone is buying. Mutual funds are structured in such a fashion that it is difficult for them to buy while everyone else is selling. If I consider myself as a fund manager, my priority will also become to keep my job and to do that I can't take contrarian position consistently.

The same is also applicable on individual stocks. A fund manager can easily take a position on a largecap well-known stock like Sun Pharma because dozens of research house always put "Buy" recommendation on that. If Sun Pharma underperforms then many more mutual funds and index will underperform. However, the fund manager can't take a position on quality microcap Pharma stock. If something goes wrong with microcap stock, then the fund manager might lose his job. Moreover, mutual funds can't invest in quality microcaps and small cap stocks where the upside potential is huge. For example, during December 2012 I had invested in Ajanta Pharma. During that period, the company had a market capitalization of around 700 crores. Now, a fund manager can’t invest in such micro cap stocks. Even if the fund manager is highly convinced about any such micro cap stocks then also he can’t take the position. Since then, Ajanta Pharma generated more than eight times return within next two years. Now at a higher price and a market capitalization of around 6,000 crores, mutual funds are entering into the stock. Similar like Ajanta Pharma, I had invested in another microcap high-quality Pharma stock, Caplin Point Lab during early 2014 at ₹100-140 (Market capitalization around 200 crores). Since then the stock already generated more than eight times return within one year. At the end of December 2014, there are no mutual fund holdings on Caplin Point Lab. I won’t be surprised if after 1-2 years the same stock will become preferred pick among fund managers.

So, the biggest wealth-creating opportunity lies in quality microcaps/smallcaps. While those small sized companies turn big, they offer spectacular return for their initial investors. Unfortunately, mutual fund can’t invest while they are small and overlooked by most of the market participants. Fund house enter while the company already turns big in size and familiar among market participants. Thus fund house always ends up with the average return.

So, the bottom line is if you have any reliable independent equity advisor then you should only stick to direct equity investment. Alternatively, if you have enough time in hand for equity research and love to spend time with stocks then also you should avoid mutual fund. It is far better to manage your money at own than to depend on fund manager. Mutual fund is beneficial if you don’t have time and reliable equity advisor for guidance in direct equity investment.

> “Go for mutual fund only if you don’t have enough time or don’t have reliable independent equity advisor to guide you.”

Can You Fully Rely Upon Your Broker?

Have you ever seen any brokerage report stating 100%-200%+ return target over 3-4 years? Have you ever received encouragement from your broker for holding a particular stock for more than two years? If brokerage house encourages investors for holding quality stocks for more than two years, then their business will dry up. You will become rich by holding long, but your broker won't generate a revenue stream. Brokerage house release research report with 10%-30% price appreciation target so that you can buy and sell frequently and thus they can earn their commission (brokerage).

Out of every 10 “Buy” report, you may find only 1-2 “Sell” report because it's hard to release “Sell” recommendation. Worse than that, while the market is going up (or already gone up), the number of “Buy” recommendations increase exponentially. All of us are familiar with the idea “Buy Low and Sell High”. However in reality opposite happens. Figure out the number of “Buy” recommendations during 2007 bull-run and compare with “Buy” recommendations during 2008-2009 bear market. Former will exceed by a huge margin.

9.4 What Should You Do?

It is better to go with independent equity advisor with proven track record. We can divide equity advisors into the following two categories-

1. **Commission Based Advisor** - One who is earning commission or brokerage on your every transaction (buy and sell)
2. **Fee-Based Advisor** - The person who charge separately and can't earn brokerage upon client's transaction. In other words, the person whose income is directly proportional to the portfolio performance of his client.

Commission based advisors must have vested interest upon every transaction. Normally they don't charge separately for advisory fees, and thus their income is proportional to the number of Buy-Sell transaction. Brokers will come under this category. Whether you are making money or not, your broker will always earn money.

Instead of taking free advice from here and there it is highly recommended to follow only fee-based advisors because their business depends on your portfolio performance. Their business will grow while their recommendations will perform. In other words, the growth of their business depends on your portfolio growth.

You may face another problem while choosing “fee-based advisory”. There hundreds of such entities offering similar service. How to choose? Followings are some warning signals that you should keep in your mind –

1. ***Avoid entities those are promising extraordinary return and asking for huge fees.*** Avoid common phrases like “100% return in a year” or “Make 10 Lacs from 1 Lac within one year” or “Earn 1 Lac every month” etc. If making money was so easy, then those entities will trade for themselves. If I know some strategy of making 100% return in 1 year then why should I inform others? Why should I offer the secret strategy for collecting huge advisory fees? Ironically, the entities those promise such extraordinary return also demand huge in-front advisory fees! Don’t be tempted with such high return promise; you can be trapped.
2. ***Avoid entities those are not offering any logic behind stock recommendations***. Seek rationale for any stock tips. What are the growth drivers for that business? Why do you think that this particular stock will perform? If you don’t get any satisfactory answers, then avoid. Don’t go with statements like “Buy ABC Ltd with target 100 and stop loss 90”. Don’t hesitate to ask the reason for the target price.
3. ***Be aware of statements like “99% accurate jackpot calls” or like “100% accuracy level”.*** Recommending stocks with target price means you are predicting future. 99% or 100% accuracy in predicting future indicates you are the God. A human being can’t predict future with 99% accuracy.
4. Be aware of entities those are calling on a regular interval to sell stock tips. If I have some quality offerings, then customers will join automatically. What’s the necessity to call repeatedly?

In short, basic common sense is sufficient enough to avoid traps. “Fee-based advisory” is the best solution if you don’t have enough time to study stock market. However, if you have burning desire to learn and can dedicate 2-3 hours per day for at least five continuous years, then you can also become your own advisor.