Five bull-market mistakes to rectify now

The ebullience in the 2017 bull run has seen many investors make wrong investment calls. Here is how you can correct them

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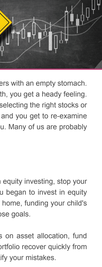

A bull market often has the same effect on investors as alcohol has on tipplers with an empty stomach. When you see great returns on your account statement from month to month, you get a heady feeling. This makes you overestimate both your risk appetite and investing skills in selecting the right stocks or funds for your portfolio. It is when the bears make their surgical strike and you get to re-examine your portfolio without rose-tinted glasses that your mistakes jump out at you. Many of us are probably in this situation in this bear market.

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If the sea of red on your portfolio statement is prompting you to lose faith in equity investing, stop your SIPs or go back to FDs, hold your horses and remind yourself of why you began to invest in equity funds. If you started your equity-fund SIPs to save up enough for buying a home, funding your child's college degree or to hang up your boots early, quitting now will mess up those goals.

It is perfectly normal even for seasoned investors to make silly mistakes on asset allocation, fund choices or investing strategies in euphoric bull markets. But to help your portfolio recover quickly from setbacks, all you need to do is to take constructive and timely action to rectify your mistakes.

Based on what our readers have been writing in to us, here are five bull-market mistakes that you should check for right away. We also tell you how you can rectify these bloopers to reap the rewards of equity investing in the long run.

Blooper #1: Overestimating your risk appetite

'I am a very aggressive investor and willing to take a lot of risk. Do suggest me four to five aggressive equity funds for SIPs of ´10,000 each.'

This is quite a common query from investors when the stock market has been upbeat for four-five years. No matter how much you caution such bravehearts investors about the risk of capital losses in equity funds, they are irresistibly drawn to them because their double-digit returns look very real, while the losses appear imaginary. But a bear phase often comes as a bucket of cold water to these investors, especially if they are first-timers.

It is one thing to dismiss the possibility of capital losses on your portfolio when you have not even begun investing and quite another to see 20 or 30 per cent of your peak-portfolio value shaved off in a couple of months. While the indices certainly do not show it, the severity of the bear grip on some of the small- and mid-cap stocks in the Indian market in the last six months has been high. Quite a few SIPs in multi-cap, mid-cap and small-cap funds now sport negative returns of 20 or 30 per cent for one year.

If you thought that you had an aggressive risk appetite but are now discovering that losing hard-earned money is giving you sleepless nights, it is time to re-evaluate your risk appetite. A bear phase is, in fact, a far better time to get a true picture of your ability to digest risks than a bull market.

To re-assess your risk appetite, go right back to your advisor. Or ask yourself a question: on what proportion of my portfolio am I comfortable losing 50 per cent in three months? Put only that portion to work in equity funds.

Your risk-taking ability should also decide your choice of fund category. Between an aggressive hybrid fund and pure equity fund, the former is a safer choice even for aggressive growth-and-value, since it is better if you take downside. Among small-, mid- and multi-cap funds, multi-cap is better if you cringe at volatility.

So if you have gone overboard with allocations to the more aggressive fund categories because you overestimated your risk appetite, it is time to re-assess your portfolio and make switches from the more risky funds to the less risky ones. Apart from the money you have already invested, the SIPs you are currently running will also need changes to reflect your actual risk appetite. So, if you are running three SIPs in mid- and small-cap funds, you want to stop two of them and start new ones in well-chosen multi-cap funds.

However, while making your decisions, do keep in mind that the losses that you see on your equity funds today are both exaggerated and temporary, just like the profits you saw in the bull market last year. It is in the nature of markets to go through cycles, and if the markets recover, these losses would have been only on paper. Avoid the temptation to swing to the other extreme on risk-aversion in this bear market as completely avoiding risks will deny your ability to meet your long-term goals.

Blooper #2: Allocating too much to equities

'My bank FDs are earning me a very low return. I don't see the point in investing in them. I would like to shift all my money to equity funds. Can you suggest some good ones?'

Given that the bull market in the last five years coincided with falling interest rates, many risk-averse categories of investors - lower-income earners, senior citizens and retirees - have made large-scale shifts in their asset allocation in favour of equities, lured wholly by the expectation of a 12-15 per cent return. The above query was from one such retiree.

But having made this shift at the best of times for equities, many such investors didn't realise that while equity gains compound at 12 or 15 per cent over a long period, those returns accrue in a very haphazard fashion. In the last 20 years, there have been only two years in which the Nifty 50 delivered precisely a 12 to 15 per cent return. There were seven years where it made losses, three years where it gained more than 50 per cent and three years where it made less than 12 per cent. Therefore, having seen strong double-digit returns on equity funds in the bull markets from 2012 to 2017, you should be prepared for two or three years of losses or sub-par returns. If you upped your equity allocations without realising this, then it is time you correct your asset-allocation mistakes.

Even if it offers low returns, having a safe fixed-income component in your portfolio (through bank FDs, corporate FDs or post-office schemes) offers three solid benefits if you are a risk-averse investor. It permanently protects one part of your capital from market volatility, earns you predictable returns to cover your basic needs and allows you to withdraw money for emergencies at any time, without worrying about where the market levels are at that particular point in time. So what should your correct asset allocation be? It should depend on two things.

One, any part of your portfolio that you will need within the next five years or that you have set aside for emergencies should not be in equities. Stock markets can be attacked by bears at any time and a less than five-year horizon does not give enough time for your capital to recover from the big loss years for the markets. Two, any part of your net worth that would give you sleepless nights if it loses 50 per cent of its value should not be in equities.

Assuming you have a ´50 lakh portfolio today that is 80 per cent (´40 lakh) invested in equities and you need ´10 lakh for emergencies and living expenses, move that money into safe bank FD-like options. Now, take stock of how much volatility you can handle in the remaining ´30 lakh of market investments. If your gut tells you that you cannot stand to see more than a ´10 lakh erosion, even on paper, invest no more than ´20 lakh (twice that amount) in equity funds and move the remaining ´10 lakh into fixed income.

Blooper #3: Start-stop SIP strategy

'I have stopped my SIPs from last year because I felt the market was overvalued. I am waiting to re-start them at a good time. Can you tell me if this is the right time?'

Much as we would like to pretend that we can call market tops and bottoms with 100 per cent accuracy, we would be lying to you if we gave you such advice.

Though SIPs do not always deliver better returns than lump-sum investments (the last one year is one such period), there are just two reasons why we keep recommending SIPs as the preferred route for ordinary investors. One, SIPs help you avoid the pitfalls of terribly wrong market timing. Think of a particularly unlucky investor who invested big lump sums in the market in January 2008, December 2010 or December 2017. You would have seen your entire investment lose 50 per cent, 25 per cent or 5-10 per cent in the very next year. By phasing out your investment over various market levels, SIPs ensure that your portfolio isn't badly buffeted by timing mistakes and doesn't give you sleepless nights.

Two, SIPs help you avoid some of the worst behavioural mistakes you can make as an investor. As an investor, one is often tempted to jump into an asset after it has delivered blockbuster returns for two-three years and to avoid it like plague when it is down and out. But to get good equity returns in the long run, you need to do exactly the opposite (buy when past returns are negative and not go overboard when they are great). Given that SIPs put your investments on autopilot, they ensure that you stay the course through the ups and downs of market cycles.

As the very purpose of an SIP is to avoid second-guessing whether we're at a market top or bottom (which no one can do well anyway), the best SIP strategy is to continue investing without giving a thought to market levels.

A start-stop SIP strategy, like the one this investor is trying, defeats the very purpose of a systematic strategy by exposing him to both timing and behavioural mistakes.

So, if you've stopped your SIPs hoping for a better time to invest, restart them right now. A falling market is the time when your SIP fetches you the maximum rewards. As to whether 2017 was a market top or whether this is the market bottom, this will be evident only five years later.

Blooper #4: Booking profits on equity funds

'I am so glad I booked profits on all my equity funds last year and am sitting on cash, waiting for the right time to invest'.

If one set of investors is aghast at the recent bloodbath in markets, another set seems very complacent that it has jumped off the roller coaster just before it started heading down. These investors were the ones who had booked profits on all equity funds sometime in late 2017, when the bull markets were still going strong.

If you had high allocation to equities, it would definitely feel good to see the losses you have avoided by booking profits on equity funds at just the right time.

But if falling markets can cause sleepless nights for investors who stay in equities through thick and thin, they don't guarantee sound sleep for those who are wholly out of the markets either. Having made a drastic decision to jump off the roller coaster at its high point, you would now be looking for a good opportunity to climb back into your seat, when it starts on its next upswing.

But while identifying high or low points is quite easy in a roller coaster, it is terribly hard in the stock market. If you booked profits on your equity funds in 2016 or 2017, you are bound to be spending the next few months in nail-biting suspense, facing a bunch of critical decisions. Should you choose a new set of funds or the ones you held earlier? Should you start SIPs or lump-sum investments to take better advantage of a sudden market bounce back? And worst of all, how do you decide if that 500-point gain on the Sensex on Monday was the beginning of the next big bull phase or just a dead-cat bounce?

Given that market bounce-backs can be just as short and sharp as market meltdowns, you may have very little time to find the answers to these questions before it is time to act. If you hesitate for too long, chances are that you will miss the best days for the market that deliver such a big boost to your long-run returns. That will leave you short of options to meet your long-term goals.

This is why we recommend that investors don't book profits on their equity funds based on market levels. You should redeem your equity fund (whether it made losses or profits is immaterial) when the financial goal towards which you invested is just one or two years away or if the fund has drifted away from its mandate or has severely underperformed its benchmark or peers.

But if you made this mistake and have been on a profit-booking spree on your funds, restart investments in good equity funds. The risk of being left out of the next bull phase is a very life one.

Blooper #5: Choosing the wrong products

An old market saying goes - Don't confuse a bull market with genius. When things are going well in the stock market, most of the investment decisions you make tend to work out splendidly. This gives many of us the belief that we possess a Midas touch with selecting stocks or funds.

But the truth is that in flyaway bull phases, like the one we saw between 2013 and 2017, risk-taking is rewarded quite disproportionately by the markets. In raging bull markets, micro-cap stocks and funds always outperform staid large-cap or multi-cap funds. IPOs do far better than established firms that have been around for decades. Managers who jump in and out of fancied stocks to ride the momentum score big over cautious buy-and-hold guys. And investors who prioritise growth over valuations fare better than value-conscious folk who look to protect downside.

Given that the risk-taking funds in the above illustrations would have topped the charts on returns in the last five years, it was quite tempting for investors to ignore funds with a seven- or 10-year record and to go for the ones that were acing their categories in the last one, three or five years. Now it is the ability to contain downside in a falling market that is the real agnipariksha for a good fund.

So if you have packed your portfolio with funds that were setting the charts on fire in 2013 to 2017 (which practically saw no correction), it is absolutely critical to re-assess your fund choices after the recent fall.

When choosing equity funds for your long-term portfolio, pay attention not just to the trailing one-, three- or five-year returns but also to how they fared in previous bear markets, like 2011 and 2008. Check out the best and worst month, quarterly and yearly data for the fund on the Value Research website to see how it has balanced risks and rewards. Give greater weight to funds with stable fund-management teams and a seasoned manager on board.

If your current funds don't fare well on the above counts, redeem them and switch to the ones that do.