Advice for beginners: Spend what's left after saving

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INVESTING is an art that every individual must learn as he starts his work life and earns his livelihood. Instead of saving what is left after spending, one should inculcate a habit of spending what's left after saving. These savings then should be channelised into investments. The basic aim of investment is to prepare a war chest for rainy days. Future is never going to be a cakewalk; one should strive for financial security to tackle any uncertainty.

There are many asset classes one can invest in. The fixed income returns are almost equivalent to the inflation of the economy, hence not a source for creating wealth over long term. Real estate requires large sum of money to be invested at one go. Moreover, real estate comes with other hassles like finding a tenant for letting it out and maintaining it periodically etc. Being an illiquid market, it becomes difficult to dispose of the real estate investment, if one needs money urgently. As against this, the equity investments can start at far less money — one can start SIP investments at as low as Rs 500 or Rs 1,000 per month. To start with let's focus on few principles:

Safety first

One should have a reserve cash of 3-6 months in the bank. This would take care of any emergency like medical crisis, travel (inland or abroad), temporary loss of job or any domestic tragedy. Equity investments are to be committed for long term; hence, one should invest only the surplus money which one does not need for at least couple of years.

Take expert advice

Being volatile in nature, understanding the equity markets is difficult. Look for an expert's advice when you initiate equity investments. Equity research is an art and science in itself. One should have adequate knowledge about market movements, valuations, macro-economics, sectoral knowledge, behavioural finance etc for making direct investments.

Do it yourself

If one plans to invest on his own, he should thoroughly study the company whose shares he is planning to buy.

Understand the business model, company's strengths and weaknesses, whether the company has pricing power etc. One should study the industry in which the company is operating along with the competitors in the industry. Since you are partnering with the management of the company, you should do the thorough check about the management of the company.

SIP-in

One can never time markets. To maximise your returns, one should invest regularly, say once a month instead of investing a lump sum in one go. This process is called Systematic Investment Plan (SIP). These days equity SIP is made available by different brokerage houses. This process enables you to accumulate a specific share or the MF units at different price points i.e. you end up buying more in falling market and less in rising market for a specified fund every month thus averaging out the cost of acquisition.

Ignore noise

An intelligent investment entails focus on the investment theme cutting away from the noise going around. The ability to manage the two vices viz. the greed and fear and following a disciplined investment regime determines the success for the investment. Avoid impulse buying or selling. Let the investment be process driven instead of emotion driven.

Avoid herd mentality

A smart investor charts his own course, avoids following others. Instead of following the trends, he anticipates them in advance. Following the crowd never yield good results, they are traps created to beguile innocent investors. Say an IPO of an established and profitable supermarket is slated three months in future. Smart investor will make and invest in the peer set right in advance to benefit from the re-rating of the whole sector and exit just ahead of the IPO making decent returns.

Diversify and reduce the risk

It goes by saying — Do not put all your eggs in one basket. Divide your investible surplus in different stocks of unrelated sectors. Volatility is the nature of equity markets. If one sector underperforms, other may outperform, thus balancing the overall returns. In addition, identify your risk tolerance; risk and reward goes hand in hand — higher the risk, higher may be the returns and vice-versa but not necessarily true in each case. Hence, try identifying opportunities with lowest risk and highest potential returns and stay invested for long term.

Balance greed and fear

Two emotions viz. greed and fear dictate the market movements. The investors react to any event on the basis of these two emotions. An investor should analyse if the event has any material impact on the investment rationale of the stock and respond accordingly. It has been proved time and again that the investment made at the time when the market is under distress has borne spectacular results over long term.

Handle boredom and envy

An average investor is more concerned about what his fellow investor makes than what he makes. He tends to keep a track of what is moving and ends up joining the herd only to get caught at the wrong end. This is an outcome of envy. Instead, he should have conviction in his own portfolio. Concentrate on the positives of his portfolio, monitor and make amend whenever necessary. The portfolio may not give spectacular returns every time, but staying invested over long term overcoming the boredom would definitely earn him decent returns instead of running after what is moving in the market.

Finally, make a beginning as "The journey of a thousand miles begins with one step".

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