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4 thumb rules from Shankar Sharma and Devina Mehra to avoid the financial ICU

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By Shankar Sharma & Devina Mehra

Big Change:
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Calendar 2020 has, so far, made almost all Indian investors, big or small, look like really sick patients. Nearly all strategies have been decimated in a market that resembled a ferocious killer dog let loose on a flock of chickens.

So what are the learnings that you should take away from this bear market?

Lesson 1: Asset Allocation Sahi Hai

Asset allocation is not just the best thing, it's the only thing. If you are just going to be a single asset (largely equity) player, then you are not going to last very long in this game.

Asset allocation basically means your investment pie chart is strategically diversified across various available asset classes.

Why should you do that? Here's the data: In 2019, government treasury instruments in India were up 9.5 per cent. Gold prices rose 24.6 per cent. In contrast, Nifty500 delivered a mere 7.7 per cent return.

In 2020, the picture is even more stark: Indian equities have fallen 25 per cent, while government securities have are up 3.4 per cent and gold has delivered 17 per cent!

But did you ever hear any fund manager or your financial adviser tell you that you were better off investing, or at least diversifying, into government paper and gold, instead of focusing on equities if you wanted the best returns? Clearly not.

The reason for this is simple: nobody in the business of fund management or financial advice makes much or any money by recommending investments in government securities or gold. The maximum fees are for recommending equity.

All behaviour, good or bad, is always driven by incentives, and equities incentivise their salespeople far more than any other asset class. Even if they do not deliver returns.

Don't ever forget this!

Lesson 2: Take a portfolio approach to Investing

Most investors believe taking individual stock advice, or 'tips', from aggressive brokers and then implementing them on their own is the way to making big money.

Wrong. This is a one-way ticket to financial ruin. The correct approach is to take a portfolio approach to determine your asset and equity selection.

For every stock you buy, be absolutely clear how much allocation to put into that stock, how much sectoral weightage does it add to your portfolio, and how does it alter the risk profile of your equity pie.

Just doing random stock purchases without having a clear plan will lead you to a point of no return in your investing life.

A case in point is the professional fund managers, who put 40% plus of their clients' money in financial stocks and saw the portfolio value erode dramatically over last few months.

Lesson 3: If there is one God in investing, it is risk management
Prevention is always better than cure. You have heard this many times. This applies equally to wealth as it does to your health.

Strong risk management is that preventive measure that can ensure that you never need to go into a financial hospital.

Avoiding big losses is about the closest to golden advice you can ever get. To illustrate, if your Rs 100 becomes Rs 65 in a market fall, you need a 50-60 per cent rise in the market to just come back to Rs.100! That's usually a 2-3 year journey.

As human beings, we are not accustomed to making decisions that recognise pain or crystalise losses. We are happier taking pills to mask pain.

Unfortunately, this approach can bring a permanent end to your investing career. And some of the most misleading advices that you hear is to keep averaging on the way down. This approach is marketed by selectively cherry-picking data.

In reality, it is always better to ruthlessly accept a loss and look for better places to deploy the remaining capital. Unless you are prepared to be brutally clinical about surgically removing losses from your portfolio, you are destined to see them grow into terminal festering wounds.

Lesson 4: Do global diversification if you want to avoid SCCARS
SCCARS stands for Single Country, Single Currency, Single Asset Risks. The 10-year data for returns from the Indian stock market in dollar terms is a shocker: It is negative 3%.

What it means is that the average Indian's wealth has been eroding in US dollar terms. In 2019, India was one of the worst performing markets in the world. Most markets gave returns ranging from 25 per cent (Italy) to 50 per cent (Russia). Even in 2020, India has been right at the bottom of the performance tables, along with Brazil.

Therefore, contrary to what is constantly told to you, India has been a very poor-performing market for several years now compared with its global peers.

If you are not diversifying your investments across the world, the market is going to extract a very heavy price at some point. Japanese investors experienced this in the 1990s, in some other parts of Asia in the late 1990s, and European investors in last 10 years.

If you strip investing of all its jargon, it is a pretty simple game: avoid big losses, stay with the winners and diversify investments across asset classes, sectors and markets.

This is the simple 'pranayam' approach to investing. And it works!

(Devina Mehra and Shankar Sharma are founders of First Global, a global investment management & securities firm)

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