

07/Guidelines for Investment in Share Market

Part I

1.0 Introduction:

- 1.1 The word '**Investment**' has a very wide/ macro meaning. We have to make investment in various categories for leading a happy life. At present I wish to concentrate on **Financial investment**.
- 1.2 **Financial investment is call of the day.**
- 1.3 The topic is very **complicated** but I will try to simplify the same for you.
- 1.4 We must first understand the **difference** between saving & investment.
- 1.5 Saving is the starting point. Investment is made out of saving. **Purpose / intention of saving & investment are slightly different.**
- 1.6 You can look at saving from two angles as outlined below.
- **Income Less Expenses = Saving**
 - **Income Less Saving = Expenses.**
- 1.7 Saving can be increased by earning more income or by reducing excessive and unwarranted expenses or by **combination** of both methods.
- 1.8 **Saving is a habit and it needs to be cultivated.**

2.0 Why we should save money?

❖ **We should save money according to our capacity for following reasons.**

- 2.1 For investment for future/ **old age**.
- 2.2 To take care of **short term needs**. e.g. Festival expenses, periodic expenses such as education, house renovation etc.
- 2.3 To meet **unexpected** expenses such as medical expenses.
- 2.4 To **purchase** / replace household gadgets such as kitchen utensils which would save our energy / entertainment articles such as TV, Radio, Transistor/utility articles such as fan, furniture, AC etc.
- 2.5 To keep certain portion of saving to meet financial / health **emergencies**.

3.0 **Which factors should be considered while making Financial Investment?**

- 3.1 **Safety** of Investment should be the prime consideration. Investment should not be lost.
- 3.2 **Liquidity:** Investment should be easily liquidated in case of need.
- 3.3 **Returns:** Investment should not remain idle but should also earn reasonable income.
- 3.4 **Spread:** Investment should be made in different forms to minimize risk.
- 3.5 **Purpose:** Investment should be made according to purpose.

4.0 **Types of Investment:**

- 4.1 Investment can be made in **Immovable** property or in **movable** property.
- 4.2 **Immovable Property:** Agricultural land, Farm house, Bungalow, Flat etc.
- 4.3 **Movable Property:** Gold, Jewellery, Silver, Bank deposits, Postal schemes, shares, vehicle, luxury articles etc.

5.0 **Security should meet the following criteria: (MASTDAY)**

- 5.1 **M** Marketability.
- 5.2 **A** Easy to ascertain its title, value, quantity and quality.
- 5.3 **S** Stability of value.
- 5.4 **T** Transferability of title.
- 5.5 **D** Durability - not perishable.
- 5.6 **A** Absence of contingent liability. i.e. You may not have to spend more money on the security to make it marketable or even to maintain it.
- 5.7 **Y** Yield. The security should provide some on-going income.

6.0 **Risks associated with holding Financial Investment:**

- 6.1 **Physical** risks such as Fire, flood loss, theft etc.
- 6.2 **Inflation:** Decrease in purchasing power of money. Our income does not grow in same proportion as increase in inflation rate.
- 6.3 **Remedies to overcome physical risks:** Household insurance, Mediclaim policy, Personal accident policy, hiring of safe deposit locker to keep investment.

7.0 What precautions should be taken in respect of Investment?

- 7.1 Investment should be made in **joint name**.
- 7.2 Investment should be payable to **either or survivor / former or survivor**.
- 7.3 **Nomination** facility should be availed of.
- 7.4 **Proper record** of investment held should be kept.
- 7.5 Your **spouse** should be **aware** of all your investment matters.
- 7.6 Excessive **faith** should not be kept on relatives, friends in respect of investments.
- 7.7 Necessary **secrecy** should be kept. The investment matters should not be discussed with strangers and at public places and also in front of family members.

8.0 **Having considered the concept of Investment from macro level, let us try to evaluate the investment in Share Market from various issues raised above.**

Security should meet the following criteria: (MASTDAY) Now let us apply these criteria's to investment in shares.

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|-----|----------|------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|
| 8.1 | M | Marketability: | Generally yes |
| 8.2 | A | Easy to ascertain its title, value, quantity and quality. | Yes |
| 8.3 | S | Stability of value. | Not guaranteed in short - medium term. |
| 8.4 | T | Transferability of title. | No problem |
| 8.5 | D | Durability - not perishable. | No problem |
| 8.6 | A | Absence of contingent liability. i.e. You may not have to spend more money on the security to make it marketable or even to maintain it. | No problem |
| 8.7 | Y | Yield. The security should provide some on-going income. | Generally Dividend will be received. |

9.1 Every person has a **dream of making quick money**. However very few really venture out to meet this dream. Those who are lucky make money but mostly you are likely to loose or won't make handsome money in the bargain.

9.2 However on a fairly long term basis (5-8 years), investment in share market should give

- better returns as compared to other avenues of financial investments such as PF, PPF, NSC, KVP, Fixed deposits with Banks and companies, Bonds etc.
- 9.3 However as stated earlier, our financial investment should be made in **different forms** to **minimize risk** and according to **purpose**. Not to forget the **safety** of investment.
- 9.4 Hence investment in share market should comprise of a **reasonable proportion** of total investment. What is reasonable will vary from person to person. Generally it should **not exceed 15-20 %** of your total financial investment as on date. I am bit conservative and readers may excuse me for that.
- 10.1 In spite of Professionally qualified in commerce faculty, I never made any investment in share market when I was young. Of course, the reasons were many such as occupational responsibilities, Share investment was in paper form, settlement period was lengthy, help of broker was necessary, non-availability of time to run after broker etc.
- 10.2 Hence I entered the share market as soon as shares were **dematerialised** and **On Line Trading** was possible from home/office PC.
- 10.3 I am now making an attempt to compile guidelines based on my professional knowledge and personal experience in share market for last few years.
- 10.4 You may be surprised that where is the necessity of **one more set of guidelines** when enough material is available regarding investment in share market in print media, TV etc. But friends, you must have realised that this material at times is **difficult to digest** for a layman and is more **focused** towards day to day movement. Share index movement on a day to day basis also baffles the ordinary investor. Every reason is available for drop in the share price but concrete reason is not known for jumping the share price very next day. **What undergoes change in share price overnight?** Is it the performance of the script, some political news, FII participation, mood in share markets across the globe? It is generally observed that that American market and European market in red previous night will affect the Asian Markets next day morning and Indian Markets in turn.

- 10.5 Investor experiences panic situation under such scenario as generally investment is made based on share tips given by friends, colleagues, brokers, media, websites etc. Even tips are sold in the evening for a nominal price at railway platform. I do not intend to under estimate these tips but wish to drive the point that **your hard earned Money should not be invested purely based on these tips** or just because your neighbour or friend is making money in the share market.
- 10.6 I am of the opinion that investment is made based on study to the extent possible, then the **risk of investment** in share market can be **minimised** over a long term of say 5-7 years.

Part II

1.0 Introduction: Investment in Share Market:

- 1.1 The first question to be answered is **choosing the company** out of more than 5000 listed companies. **Following parameters** should be considered, analyzed and evaluated before choosing the company. You have to **track** these parameters **continuously** even after purchasing the shares. **Most of the data /parameters are readily available on <http://money.rediff.com> or many such websites.**

2.0 Basic decisions & actions to be taken once you decide to invest in share market:

2.1 Demat account should be opened.

- Demat account should be opened in any Nationalized Bank. Demat account should be opened jointly. Nomination should also be made. You need to open bank account along with Demat account.

2.2 Whether to do On Line Trading or through Broker?

- Online Trading tie up has been made by Nationalized Banks with various Brokers. e.g. State Bank of India has a tie up with Motilal Oswal Securities. On Line Trading is more convenient way of investing in share market. Your bank account gets credited for the shares sold, dividend received. Shares sold are deducted from Demat account. No need to run after the broker. Shares can be lien marked permanently and instruction can be given over the phone to sell the script. Similarly once margin has been provided, then

shares can be purchased by telephonic instruction.

2.3 How much investment you intend to do in shares?

- As stated earlier, your investment in share market should not exceed 15 % of total financial investment as on date. Initially you may invest say 50 % of that and keep balance for investment when market falls sharply.

2.4 Investment to be made at a time or gradually over a period of say 6 months depending on Sensex?

- Entire investment should not be made at a time but you must keep your list of companies ready and should make the investment on dips in prices and after considering other prevailing factors. Investment should be made over say next 6-12 months.

2.5 Selection of sectors.

- You have the option of selecting various sectors such as : AUTO | BANKEX | CD | CG | FMCG | HC | IT | METAL | OIL&GAS | PSU | REALTY | TECK | POWER.
- You **need not invest in every sector**. Sectors with **minimum government control** should be selected.
- Consider as to How sector is **classified?** e.g. Growing, Steady, Infant.
- **National Policy:** The current, future policy or Budget of the country may favour, encourage certain industry (software, power, telecom, construction etc) & allied industry.
- Whether the industry is **controlled** by Government Regulatory authority. Government decision to control the price of the product/service will affect the share price. These things may be of short or medium or long term phenomena.
- The **economic data** announced by Government also affects the market in short term & medium term. e.g. High GDP growth is considered positive. More Foreign Exchange reserve is considered good. Less Interest rate is considered good.

2.6 Selection of companies in each sector.

- You must invest in atleast **2-3 companies in each sector** for better spread of risk.
- Is it a **growing** company? Increase in sales, net profit, operating profit.

- **Size** of the company: Large, medium, small.

2.7 Decide the proportion of investment in each sector and in individual script.

- Investment in each sector should not be more than **10-15%** of your investment in share market. Obviously your investment in one company should not exceed 5 % of your investment in share market.

2.8 How long you intend to hold shares? (Time dimension of investment.)

(0-3 years, 3-5 years or over 5 years) Returns will be averaged out over a long period of say over 5 years.

- As stated earlier, your returns over a long period would be better than other investments.
- Some stocks (small company, lesser known, unstable performance) may be good at times depending upon market mood but they may bring loss in the long run.
Good company shares considering the various parameters will fetch good returns in the long run (5 to 10 years)

Part III

1.0 Guidelines for investing in Share Market:

- **How much a stock rises or how fast stock rises depends ultimately on current, future earnings of the company.** When this is fully accounted in the stock price, investors tend to book profit thereby stock prices start falling to small extent. This is called **market correction**. This is good and healthy for stock market. **You have to buy at low & sell at high price.** 20% of profit should be considered moderate. The target price of the stock depends on what parameters are driving the stock price & how much steam is behind it.

2.0 Management:

2.1 What is the management stake?

- You can get this information from Share holding details. **Higher the management stake, better it is.**

- The Promoter holding of around 40 to 60 % is good. It means they have interest, confidence in the company.

2.2 Whether management is in the hands of Professionals?

- This information will be available from annual accounts and website of the company.

2.3 Whether company is managed by any Family?

- This information will be available from annual accounts and website of the company.
If yes, whether the family members are professionally qualified?

2.4 What is the policy of the management?

- Is it conservative, aggressive, growth oriented investor friendly? You may need to **read** the directors report, reports of press conferences, press news, website of the company etc.
- Capital expansion, Geographical market expansion, Diversifying product portfolio, Market penetration, Entering foreign market.

2.5 Whether Financial institutions have nominated their directors?

- Directors are nominated when ever financial institutions have substantial share holding in the company. Hence there would be a **fair chance** of **outside control** on the company affairs. But this may not be happen practically. It is better if you guess.

3.0 Share holding:

3.1 Shares held by Indian Promoters, Foreign Promoters, Banks & insurance holding, FII's, Private corporate bodies, directors, NRI's, General Public.

- You can get this information from Share holding details.

3.2 Whether share holding is constant or increased or gradually reducing?

- Preferably, share holding of Promoters and FII's should be either **constant** or should show **upward trend**.

3.3 Whether Mutual Funds, FII's have invested in the company?

- If the stocks are held by renowned Mutual funds, financial institutions, foreign

investors, it means they have studied and selected. It is a very good, **positive indication** for you. If above institutions increase/decrease the stake follow it but don't get too much carried away by their short term action.

3.4 What is the capital structure?

- Capital Structure: Authorized, Issued, Paid up, face value etc. This information is also available on website.

4.0 Business of the company? (Business: Market leader, Monopoly, many competitors)

- 4.1 Products manufactured.
- 4.2 Whether production is seasonal or throughout the year?
- 4.3 Whether demand is seasonal or throughout the year?
- 4.4 Features of the product and plus points over other products.
- 4.5 Who are the main competitors?

- 4.6 Who are the main customers?
- 4.7 What is the Demand & Supply position?
 - Existing
 - Future
- 4.8 Market share: Existing & Future
- 4.9 Location of market
- 4.10 Exports

- 4.11 Whether Indian / Foreign standards have been specified?
- 4.12 Whether the product meets the said standard?
- 4.13 Quality control / R & D facilities.
- 4.14 Is it a standard product or to be produced against order booking?
- 4.15 Life of the product

- 4.16 Cost of production, margin
- 4.17 Gross margin on sales
- 4.18 **One should also review the status of a product (traded or manufactured) in commodity exchange? Company performance will ultimately depend on the product.**

5.0 Raw Material requirement:

- 5.1 Whether Raw Material produced in house or Purchased?
- 5.2 Who are the main suppliers of Raw Material?
- 5.3 Availability of Raw Material: freely, controlled?
- 5.4 Availability of Raw Material: Existing & Future?
- 5.5 Whether Raw Material is available throughout the year or seasonal?
- 5.6 Whether Raw Material is indigenous / imported / controlled?
- 5.7 Main items of Raw Material
- 5.8 **One should also review the status of a product (i.e. Raw Material) in commodity exchange? Company performance will ultimately depend on the product.**

6.0 Manufacturing process:

- 6.1 Technical know how: Foreign / Local
- 6.2 By-products if any
- 6.3 Advantages of alternate Technologies
- 6.4 Technology: Stable / fast changing
- 6.5 Length of production cycle
- 6.6 Whether material / WIP is sent out for processing?

7.0 Infrastructure Analysis:

- 7.1 Location advantages of the project
- 7.2 Transport facility
- 7.3 Nearness to market
- 7.4 Availability of raw material
- 7.5 Availability of power / fuel
- 7.6 Availability of water
- 7.7 Availability of skilled labour
- 7.8 Government incentives such as capital subsidy, sales tax concession etc.
- 7.9 Availability of communication network

8.0 Profit & Loss Account & Balance Sheet:

8.1 Study Quarterly, Half yearly and **Annual P&L** and various **ratios**. One may refer section Books → Management → Financial concepts on www.spandane.com

8.2 **Current quarter results** should be compared with previous quarter and also with same quarter of last year as company performance may vary quarter to quarter depending on product mix.

8.3 **Operating Margin (OPM):** When OPM of the business increases, stock price will go up. When raw material costs goes up profitability reduces hence stock price also.

8.4 Study **Balance Sheet** of the company.

9.0 Price earning ratio: (P/E = Stock price/Earnings Per Share)

9.1 This ratio is most **crucial** for decision making. If it is too high, the stock is expensive. **Compare P/E Ratio with peers in the same sector.**

9.2 High growth, good company will have high value 30 to 40 (telecom, software, pharma) Yet it is justified considering its future prospects. **As a thumb rule P/E Ratio of about 20 may be considered as bench mark.**

9.3 **Each industry will have different average P/E depending on future prospects.**

9.4 **Normally when a stock reaches high P/E Ratio, share price starts falling which is called correction (due to profit booking)**

9.5 **One can estimate the price range of a script.** e.g existing P/E ratio is 22. (Price Rs. 220/- & Earning per share Rs.10/-) If expected earning per share would be Rs.13/- next year, then it is quite likely that price may rise to Rs.286/-. **Such EPS guidance is given in quarterly accounts submitted to stock exchange.** Compare the estimated price Rs.286/- with current price Rs.220/- and then take decision. If estimated EPS falls to Rs.12/- even then price should be around Rs. 264/-.

- 9.6 You would also observe that whenever a company bags order or gets tender, share price shows some upward movement that day. The logic is that profitability will increase and hence EPS will also increase.
- 9.7 **Companies with very high PE Ratio or at times minus PE Ratio show high volumes of trade and price fluctuations.** But in case of correction, such script gets corrected sharply and again takes its time without any guarantee to restart its run in the trading.
- 9.8 **Compare EPS with face value of a share.** e.g. If face value is Rs.1/- and EPS is Rs. 10/-, it means that company is earning Rs.10/- per share. **Higher EPS figures should be Preferred.** It should be compared with competitors. Reliance Industry has earned Rs.49.65 per share of a face value of Rs.10/- for the year ended 31-03-2010.
- 10.0 **Book Value of share:**
- 10.1 **Book value** = Actual value of companies Assets Less Liabilities or Net Worth / No. of shares.
- 10.2 Stock price under book value should be considered / compared with price at which the script is traded.
- 10.3 **Price/book value varies with the industry.** Compare with peers in the same sector.
- book value - Less for more skill based, knowledge based industry
 - Book value - more for Capital & infrastructure intensive industry
- 11.0 **Equity size: This is number shares that entire market capital consists of.**
- 11.1 Less equity (10 million) means rapid movement of stock price.
Large equity (>100 million) stable stock price. Extent of Rise/fall will not be too much.
In any case one should not forget about liquidity
- 12.0 **Dividend & Bonus shares issued:**
- 12.1 **Dividend** % age over last 10 years. Company which pays dividend regularly is liked by the investors. Whether dividend % varies from year to end?

- 12.2** Review **dividend payout ratio**. (Dividend per share divided by earning per share.)
Is it consistent over the years?
- 12.3** **Bonus given in previous years**. If you observe the trend of issuing bonus shares, then one can predict bonus issue in near future. Some companies may not pay exorbitant Dividend but may issue bonus shares at regular intervals.
- 13.0** **Review of Script**: Every script should be reviewed on an ongoing basis after purchase. Following data is readily available on website for review.
- 13.1** **Price**. Is it near to share price of last 52 weeks high?
- 13.2** **Volume**: Average Number of traded shares should be adequate (more than 10000). Otherwise you may not find a buyer when you want sell the stock.
- 13.3** **Mutual Fund Holding**. Is it increasing, decreasing?
- 13.4** **Sales**: Upward trend or downward trend.
- 13.5** **Net Profit Margin**: Upward trend or downward trend.
- 13.6** **How stock is classified?** Cold or Hot based on last 15 days trading figures.
- 13.7** **Market Cap**: Market cap is an abbreviation of market capitalization. Market cap refers to the value or capitalization the market puts on a company. **It is calculated by multiplying the price of the shares by the number of shares issued**. Market cap is only one of many ways to value a company. Market cap is frequently broken down into the following ranks: mega cap, large cap, mid cap, small cap, micro cap, and finally nano cap -- the largest to smallest.
- Another common method used to value a company is the **book value**. **The book value is calculated as the difference of a company's Assets and its Liabilities**. The book value is also referred to as the **Net worth** of the company.
- The market cap of a company and the book value of a company are almost never the same value.**
- A high growth company typically has a much higher market cap than book value, while an established company with little growth expectations usually has a market cap that is closer to the book value.
- It is important to realize that both market cap and book value are really **just opinions**. **If investor thinks the market cap value is too high with respect to the book value, he**

will try to sell the shares. If investor thinks the market cap is too low, then he will try to buy shares in the company.

- 13.8 **Share price movement** for the day, for the week, for the month, 6 months, one year, High & Low in last 52 weeks.
- 13.9 **Market Tips** may be judiciously weighted.
- 13.10 **Sales** Last quarter.
- 13.11 **NP Margin** Last year end
- 13.12 Last dividend
- 13.13 Last Bonus.
- 13.14 Return on average equity

- 13.15 **Company Announcements**, Next board meeting etc. If expected performance for the quarter / year is likely to be good, you will observe upward swing in the price few days' prior to declaration of results. If declared results are not as expected by the market, then on the day of results/board meeting, share price may come down.
- 13.16 **Competitors & their performance.** Share prices of competitors are given on the same web page.
- 13.17 **Discussion Board**, Questions raised by other share holders and replies given. May not be reliable but still may be helpful at times.

Part IV

- 1.0 **Disclaimer:** I do not claim that this is the complete and exhaustive commentary on **Investment in Share Market.** However I have made an attempt to cover the important parameters which should be considered for choosing the script. One should always supplement the knowledge by referring to various websites, magazines, newspaper articles etc.
- 2.0 **I have also taken the liberty to assume that the investor is conversant with internet surfing and basic concepts of share market.**
- 3.0 It is also necessary to keep proper record of share investment. One may refer 'Personal Data Formats' section of www.spandane.com.
- 4.0 Taxation aspect also should be considered while dealing in Stock Market.
- 5.0 Best wishes for your safety of investment and your dream of making money in stock market.

- 6.0 It is suggested that initially transactions should be made for delivery. Intra day trading may be tried once you gain adequate experience in Stock Market.
- 7.0 Your suggestions, observations and comments may be informed by email to spandane2008@gmail.com.

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