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Buy low & sell high a tough call

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If past history was all there was to the game, the richest people would be librarians
–Warren Buffett

I had once heard that the reason they make huge windshields and small rear view mirrors in cars is to indicate where the driver should be looking most of the time — right ahead. The same is majorly applicable to investing.

Unfortunately, in general, investors end up doing precisely the opposite. So if a friend of mine has recently shared with me how he made money in gold and real estate, then that would weigh on my mind and I would feel like having missed the bus. At the same time if the last news article I read was about how the global economy is in a poor shape and India too has not been spared, with GDP growth at a decade low of sub 5%, it is very unlikely that I would invest in equities. While making an investment, our recent memory tends to be a major guiding force.

In fact, that's how we make even our non-monetary decisions. So if there has been a robbery at our neighbour's place, then we will suddenly get more careful about security for our own house and might end up buying insurance or increase cover in our existing one. We will most likely also add some security equipment. In any such instance, the probabilities of the event affecting us before or after do not change. However, we suddenly become more aware of it and pay more attention to it. Over time, the memory fades. We have included a table here which indicates collective investor behaviour.

TRYING TO BE PAST-PERFECT

Annual net sales of equity mutual funds

Fiscal year	Sensex level at fiscal's close	Absolute returns	Net sales in equity funds (in ₹ cr)
2002-03	3,049	-12.1%	118
2003-04	5,591	83.4%	7,205
2004-05	6,493	16.1%	7,398
2005-06	11,280	73.7%	36,155
2006-07	13,072	15.9%	29,916
2007-08	15,644	19.7%	52,701
2008-09	9,709	-37.9%	4,084
2009-10	17,528	80.5%	1,456
2010-11	19,445	10.9%	-11,795
2011-12	17,404	-10.5%	504

Source: BSE, AMFI websites

What explains investors putting in more and more money as equities become more and more expensive? Do we even know how to evaluate cheap and expensive assets while investing? It seems recent history overrides everything. So as returns become more dramatic, people get dazzled more and start investing more of their money. In many cases, this is not just an increase in absolute sums but also an increase in percentage of their overall portfolio.

So even an investor who was making money initially loses it by the end of the cycle as the gain is on a smaller exposure and the loss later on is on a much higher investment value. It is no surprise then that the people who have lost money in stocks far outnumber the ones who have made money. It seems that the problem is not with the market but with us as investors. It is likely that the same problem permeates other asset classes too. It definitely gets accentuated in equities. Buy low and sell high is easier said than done.

This behaviour leads to an average investor's investing experience being different from the data and records shown by a fund house or an asset class. So even though the sensex has grown at a compounded annual rate in excess of 16% (dividends excluded) since its inception in 1979, it is difficult to find investors who have experienced the same in their portfolio. In fact, there is an annual study 'Quantitative Analysis of Investor Behaviour (QAIB)' done by Dalbar which repeatedly suggests that an average investor's return is far lower than the returns of an asset class or what a mutual fund might suggest.

What I am trying to drive home is that we should not get overawed by the recent performance of any investment or asset class at the time of making an investment. Instead, we should evaluate each situation and investment objectively. The question here is what can go wrong and the probabilities of it going wrong. What are we basing our decision on? Facts and data, or something else? If it is indeed facts and data, then is the source credible? Can the data be skewed for a certain reason?

Focus on maintaining a certain asset allocation based on your ability to take risks than on trying to time the market. It is boring and difficult to stick to such a strategy, but it will help you avoid a lot of regret.

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