Steps to Successful Investing

Ten Basic Rules for Successful Investing

Experience has shown that what separates the winners from the losers is knowing "rules" for successful investing.

1. **Have Clear-Cut Investment Objectives and a Realistic Plan to Get There**
   Whether you have short-term needs to buy a car or take a vacation, medium-term needs to fund college education or long-term needs to develop a retirement income, your objectives must be clearly stated with a time horizon and dollar requirements. Competing objectives must be prioritized. Your objective, for example, should be to have so many rupees in so many years, assuming a stated level of risk. You must then have a realistic plan to make it happen. You cannot assume unreasonably high investment returns without assuming unreasonable risk. The level of savings and the time horizon must be sufficient to allow steady and relatively safe compounding of your assets.

2. **Achieve a Correctly Balanced Portfolio**
   You should not have all of your assets in any one type of investment, however good it may look today. You must diversify broadly. You should not be all in stocks, all in bonds, all in real estate, or all in cash. Even with a small portfolio it should be spread among several investment types to protect your assets and minimize your risk. The correct split among different types of investments varies depending upon your unique situation.

3. **Ensure Adequate Diversification of Stocks**
   The market does not reward the investor for unnecessary risk, only for unavoidable risk. Being inadequately diversified is both unnecessary and dangerous. Two-thirds of investors who own individual stocks hold ten or fewer stocks. Recent studies have shown that many times that number is necessary for adequate diversification. This problem can largely be overcome by owning a diversified mutual fund. However, even then, some diversification between funds is necessary, and it is wise to own several diversified funds having different objectives and management styles.

4. **Match Your Investments to Your Risk Tolerance**
   It is obvious that a retired couple living on a fixed income, with limited capital assets, should not purchase the same investments as a young, single, highly-paid person with secure employment and significant assets. The appropriate levels of risk are quite different. Most cases, however, fall between these extremes and require careful analysis. On average, over sufficient time, increasing risk will produce increasing rewards although there are limits to this generalization. In the investment world the race between the hare and the tortoise is often won by the tortoise. There is an optimal level of risk for you, and this is where your investments should be placed. To assume more risk is dangerous for you and to assume less is wasteful.

5. **Let Your Time Horizon Dictate Your Investment Vehicles**

If you are investing for less than a five-year period you should probably not invest in the stock market at all, as you may have to sell when the stock market is depressed. You would be better to invest in money market funds or short-term bond funds. History shows that stocks have the best performance over time, but over a one-year period they have shown a loss in 20 years out of 64 years or about 31% of the time. Even over five-year periods, losses have been recorded, but with less frequency. By comparison, over twenty- year periods no losses have been recorded and substantial gains have been achieved.

6. **Exploit the Incredible Power of Compounding With Tax Deferral**
   If you are young and can invest fairly small sums of money on a regular basis, you can win the money game quite easily. The power of compounding is on your side. For example, suppose you can put Rs. 2,000 a year or Rs. 167 a month into a tax deferred vehicle such as an IRA or an annuity, starting at age 30. By the time you must start taking some out at age 70 1/2, you will have contributed Rs. 80,000, and assuming a return of 10% per year, it will be worth Rs. 975,000. If this is left to compound further, apart from the withdrawal of an annual income for the remainder of your life expectancy, you will enjoy a taxable income starting at almost Rs. 60,000 a year and steadily increasing over the next 18 years to over Rs. 300,000 per year. All this for an original investment of Rs. 80,000 accumulated over 40 years at just Rs. 167 per month. Such is the incredible power of compounding. If there is a secret to financial success, then this is it.

7. **Carefully Select the Best Investments**
   Use no-load mutual funds and measure performance on a risk-adjusted basis. Fund selection must reflect your stated overall investment objectives and appropriate level of risk tolerance. If in doubt, err towards the more conservative. Don't buy funds simply because they are fashionable or exciting or because they did well last month or last year. Don't buy anything which is complicated or which you don't fully understand. You can take the help from your Financial Advisor. That is what leads to success. Most of all, be focused.

8. **Objectively Manage Your Investment Portfolio**
   Any business needs good management and your investments are your business. Allocate regular time at least monthly to manage your business. Good portfolio management requires discipline and patience. Don't be swayed by the emotions of the moment. Stick to your chosen strategy. You are investing for the long term. Use an objective "automatic" system of decision making that lets you buy, sell, or switch according to a set of rules that you have adopted. Otherwise your decisions will be influenced by short-term random movements of the market. Learn to step back and observe from a distance. Control your normal emotions of fear and greed. They are your worst enemies. Beware of hasty decisions based on daily financial news and observe only the longer term trends. Do not try to time the market by short-term trading, as over time you are likely to lose. Your objective system will alert you to important longer term changes of trend in the market or in your funds; it will tell you when to take action.

9. **Exploit Investor Psychology**
   To buy when everyone else is selling and to sell when everyone else is buying is the simple way that

fortunes have been made through the ages. To do this you must side-step the madness of the moment and keep cool and calm in an excited market. You need to discount the latest market scare on the TV news, you must ignore the magazine cover announcing that the market can now only go up (or down). You must return to your basic strategy, remembering that your time horizon is years and not just a few days. Pause to check the several trends that indicate market direction.

10. **Understand the Long-Term Impact of Taxes and Inflation**
    The combined effect of taxation and inflation is the most insidious and certain enemy of the investor. Many people tend to ignore it until too late, because it is not as dramatic as a sudden drop in the market, but it is far more serious. Over time, the market will bounce back, but losses due to taxes and inflation are gone forever and will be repeated again year-after-year. Unless your investment returns are sufficient to this effect, your portfolio will suffer constant and cumulative erosion of purchasing power. Ill-informed investors who are very risk averse tend to place their assets in passbook savings accounts, certificates of deposit or Treasury Bills in a futile attempt to avoid all risk. What they actually achieve is to exchange a possible market risk for a virtually certain and more insidious purchasing power risk.