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INVEST IN STOCK MARKET: TODAYS NEED

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ABSTRACT
Before we address the above question, let us understand what would happen if one choose not to invest. Let us assume you earn Rs.50,000/- per month and you spend Rs.30,000/- towards your cost of living which includes housing, food, transport, shopping, medical etc. The balance of Rs.20,000/- is your monthly surplus. For the sake of simplicity, let us just ignore the effect of personal income tax in this discussion

1. *To drive the point across, let us make few simple assumptions.*
2. *The employer is kind enough to give you a 10% salary hike every year*
3. *The cost of living is likely to go up by 8% year on year*
4. *You are 30 years old and plan to retire at 50. This leaves you with 20 more years to earn*
5. *You don't intend to work after you retire*
6. *Your expenses are fixed and don't foresee any other expense*
7. *The balance cash of Rs.20,000/- per month is retained in the form of hard cash Going by these assumptions, here is how the cash balance will look like in 20 years as per Table*

KEYWORD: *Stock Markets, Salary, Balance, Per Month Invest*

INTRODUCTION

Fixed Income Instruments- These are investable instruments with very limited risk to the principle and the return is paid as an interest to the investor based on the particular fixed income instrument. The interest paid, could be quarterly, semi-annual or annual intervals. At the end of the term of deposit, (also known as maturity period) the capital is returned to the investor. Typical fixed income investment includes:

1. Fixed deposits offered by banks
2. Bonds issued by the Government of India
3. Bonds issued by Government related agencies such as HUDCO, NHAI etc.
4. Bonds issued by corporates

As of June 2014, the typical return from a fixed income instrument varies between 8% and 11%

Equity: Investment in Equities involves buying shares of publicly listed companies. The shares are traded both on the Bombay Stock Exchange (BSE), and the National Stock Exchange (NSE). When an investor invests in equity, unlike a fixed income instrument there is no capital guarantee. However as a trade-off, the returns from equity investment can be extremely attractive. Indian Equities have generated returns close to 14% – 15% CAGR (compound annual growth rate) over the past 15 years. Investing in some of the best and well run Indian companies has yielded over 20% CAGR in the long term. Identifying such investments opportunities requires skill, hard work and patience. You may also be interested to know that the returns generated over a long term period (above 365 days, also called long term capital gain) are completely exempted from personal income tax. This is an added attraction to investing in equities.

Real Estate: Real Estate investment involves transacting (buying and selling) commercial and non-commercial land. Typical examples would include transacting in sites, apartments and commercial buildings. There are two sources of income from real estate investments namely – Rental income, and Capital appreciation of the investment amount

The transaction procedure can be quite complex involving legal verification of documents. The cash outlay in real estate investment is usually quite large. There is no official metric to measure the returns generated by real estate, hence it would be hard to comment on this.

Commodity: Bullion Investments in gold and silver are considered one of the most popular investment avenues. Gold and silver over a long-term period has appreciated in value. Investments in these metals have yielded a CAGR return of approximately 8% over the last 20 years. There are several ways to invest in gold and silver. One can choose to invest in the form of jewellery or Exchange Traded Funds (ETF).

Going back to our initial example of investing the surplus cash it would be interesting to see how much one would have saved by the end of 20 years considering he has the option of investing in any one – fixed income, equity or bullion. By investing in fixed income at an average rate of 9% per annum, the corpus would have grown to Rs.3.3 Crs

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2. Investing in equities at an average rate of 15% per annum, the corpus would have grown to Rs.5.4 Crs
3. Investing in bullion at an average rate of 8% per annum, the corpus would have grown to Rs. 3.09 Crs

Clearly, equities tend to give you the best returns especially when you have a multi – year investment perspective.
A note on investments - Investments optimally should have a strong mix of all asset classes. It is smart to diversify your investment among the various asset classes. The technique of allocating money across assets classes is termed as 'Asset Allocation'.

For instance, a young professional may be able take a higher amount of risk given his age and years of investment available to him. Typically investor should allocate around 70% of his investable amount in Equity, 20% in Precious metals, and the rest in Fixed income investments. Alongside the same rationale, a retired person could invest 80 percent of his saving in fixed income, 10 percent in equity markets and a 10 percent in precious metals. The ratio in which one allocates investments across asset classes is dependent on the risk appetite of the investor.

What are the things to know before investing- Investing is a great option, but before you venture into investments it is good to be aware of the following…

1. Risk and Return go hand in hand. Higher the risk, higher the return. Lower the risk, lower is the return.
2. Investment in fixed income is a good option if you want to protect your principal amount. It is relatively less risky. However you have the risk of losing money when you adjust the return for inflation. Example – A fixed deposit which gives you 9% when the inflation is 10% means you are net net losing 1% per annum. Fixed income investment is best suited for ultra-risk averse investors
3. Investment in Equities is a great option. It is known to beat the inflation over long period of times. Historically equity investment has generated returns close to 14-15%. However, equity investments can be risky
4. Real Estate investment requires a large outlay of cash and cannot be done with smaller amounts. Liquidity is another issue with real estate investment – you cannot buy or sell whenever you want. You always have to wait for the right time and the right buyer or seller to transact with you.
5. Gold and silver are known to be a relatively safer but the historical return on such investment has not been very encouraging

What is a Stock Market?
Investing in equities is an important investment that we make in order to generate inflation beating returns. This was the conclusion we drew from the previous chapter. Having said that, how do we go about investing in equities? Clearly before we dwell further into this topic, it is extremely important to understand the ecosystem in which equities operate.

Just like the way we go to the neighbourhood kirana store or a super market to shop for our daily needs, similarly we go to the stock market to shop (read as transact) for equity investments. Stock market is where everyone who wants to transact in shares go to. Transact in simple terms means buying and selling. For all practical purposes, you can't buy/sell shares of a public company like Infosys without transacting through the stock markets. The main purpose of the stock market is to help you facilitate your transactions. So if you are a buyer of a share, the stock market helps you meet the seller and vice versa. Now unlike a super market, the stock market does not exist in a brick and mortar form. It exists in electronic form. You access the market electronically from your computer and go about conducting your transactions (buying and selling of shares).

Also, it is important to note that you can access the stock market via a registered intermediary called the stock broker. We will discuss more about the stock brokers at a later point. There are two main stock exchanges in India that make up the stock markets. They are the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Besides these two exchanges there are a bunch of other regional stock exchanges like Bangalore Stock Exchange, Madras Stock Exchange that are more or less getting phased out and don't really play any meaningful role anymore.

Stock Market Participants and the need to regulate them
The stock market attracts individuals and corporations from diverse backgrounds. Anyone who transacts in the stock market is called a market participant. The market participant can be classified into various categories. Some of the categories of market participants are as follows:

1. Domestic Retail Participants – These are people like you and me transacting in markets
2. NRI's and OCI – These are people of Indian origin but based outside India
3. Domestic Institutions – These are large corporate entities based in India. Classic example would be the LIC of India.
4. Domestic Asset Management Companies (AMC) – Typical participants in this category would be the mutual fund companies such as SBI Mutual Fund, DSP Black Rock, Fidelity Investments and HDFC AMC etc.
5. Foreign Institutional Investors – Non Indian corporate entities. These could be foreign asset management companies, hedge funds and other investors

Now, irrespective of the category of market participant the agenda for everyone is the same – to make profitable transactions. More bluntly put – to make money. When money is involved, human emotions in the form of greed and fear run high. One can easily fall prey to these emotions and get involved in unfair practices. India has its fair share of such twisted practices, thanks the operations of Harshad Mehta and the like. Given this, the stock markets need someone who can set the rules of the game (commonly referred to as regulation and compliance) and ensure that people adhere to these regulations and compliance thereby making the markets a level playing field for everyone.

The Regulator

In India the stock market regulator is called The Securities and Exchange board of India often referred to as SEBI. The objective of SEBI is to promote the development of stock exchanges, protect the interest of retail investors and regulate the activities of market participants and financial intermediaries. In general SEBI ensures…

1. The stock exchanges (BSE and NSE) conducts its business fairly
2. Stock brokers and sub brokers conduct their business fairly
3. Participants don't get involved in unfair practices
4. Corporate's don't use the markets to unduly benefit themselves (Example – Satyam Computers)
5. Small retail investors interest are protected
6. Large investors with huge cash pile should not manipulate the markets 7.Overall development of markets

Given the above objectives it becomes imperative for SEBI to regulate the following entities. All the entities mentioned below in Table 2.1 are directly involved in the stock markets. A malpractice by anyone of the following entities can disrupt what is otherwise a harmonious market in India. SEBI has prescribed a set of rules and regulation to each one of these entities. The entity should operate within the legal framework as prescribed by SEBI. The specific rules applicable to a specific entity are made available by SEBI on their website. They are published under the 'Legal Framework' section of their site.

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