INVESTMENT NAVIGATOR

Expect the unexpected on your investment portfolio

—Vishal Dhawan

THE Reserve Bank of India (RBI) surprised economists and investors earlier this week by raising interest rates by 0.5 per cent. Earlier this month, Infosys declared results that were below expectations, resulting in the stock losing value. Most investors would remember the election result days of 2004 and 2009. In 2004, the stock markets lost a significant amount of value because the election results were unexpected with the BJP losing elections that they were expected to win, whilst exactly the opposite happened in 2009 when the Congress-led coalition got a comfortable majority that they were not expected to get, and both stocks and real estate had some of their biggest gains as a result.

These are just a few instances where investors saw their portfolios being impacted by an unexpected set of events. Whilst it would be nice to believe that such unexpected events are few and far between, the reality is that investors need to be aware that unexpected events are a part and parcel of investing, irrespective of the kind of instrument that you use. Whilst an investor may believe that he is insulated from these events if he buys a bank fixed deposit, that is not actually true. An investor who bought a bank deposit one year ago when FD rates were 7 per cent per annum has actually been hit by inflation that has been in the range of 9-12 per cent over the last one year contrary to the expectations that inflation will be in the 6 per cent range.

Thus, bank deposit portfolios have effectively lost their purchasing power over the last one year.

So what can one do to manage the unexpected?

1. Understand the asset class that you are investing in—Investments in asset classes like stocks, real estate and commodities are inherently volatile and unpredictable over short periods. Since real estate has done very well over the last few years, a large number of investors believe that real estate can only go up. Whilst that is generally true over long periods of time, it does not hold true for shorter periods when prices can move in either direction.

Similarly for stocks, past data shows that the probability of making losses on your portfolio is in excess of 30 per cent when you invest for short periods like one year, but reduce significantly when you invest for periods in excess of 5 years. To manage this uncertainty, it is appropriate to invest in volatile asset classes only for goals that are longer term in nature. There is a tendency to do the reverse, wherein asset classes like stocks and real estate are used for quick short term gains which these asset classes are not conducive to.

Investors need to keep this in mind for gold as well, where a large number of investors are coming in with the short term in mind seeing the recent outperformance of gold *vis-à-vis* other asset classes.

2. Plan for emergencies—It is critical to have a contingency fund of 3-12 months available in a very liquid manner through instruments like bank deposits or liquid funds. This may be required for a medical emergency or the inability to work due to an unexpected accident or illness. Insurance, available for your life, health, disability and property can go a long way in covering for the emergency. Buying vanilla term insurance covers, for example, are not a waste of money but preparing for the unexpected. Think about the families who lost their near and dear ones to the bomb blasts in Mumbai a fortnight ago. I'm sure no one expected an event of that kind.

3. Take advantage of the unexpected—Certain unexpected events can actually turn out to be opportunities. Investors who bought into the shock election results of 2004 have seen their portfolios grow more than 4 times in the last 7 years. Be ready for these opportunities by holding a portion of your portfolio liquid so that you can take advantage of these opportunities. It is often hard to distinguish between the hard knocks and those of opportunity.

You may need to seek the help of your financial advisor to recognise the difference.

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Vishal's rich experience of 15 years in the financial services industry has led him to frequently write columns and appear on television, including CNBC and Bloomberg UTV. He shares his insights and views in various leading publications, including the **Wall Street Journal, Economic Times, Indian Express, Reader's Digest, ET Wealth, Asian Age** *and* **Deccan Chronicle.** *He is also a member of the Financial Planning Association, USA.*

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