Is crashing market good to buy or sell?

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AS I walked through a multibrand garments mall, I found that most shoppers had bags that were overflowing with clothes of different shapes and sizes. The salary increases and bonuses were probably being put to use. And of course, the big draw.

However, things in the financial markets seemed very different. With the sharp correction in recent weeks on the back of the concerns around the long-term sustainability of the European Union having brought the prices of a large number of stocks down significantly, there seemed to be a dearth of investors willing to buy.

Stock markets have historically been a place where the number of people buying decreases with the drop in price.

Thus, a 30 per cent sale in the stock market does not normally see investors stocking up like they do when they see the discount sign in a shopping store. Remember the sub 10,000 levels on the Sensex in the end of 2008 and early 2009.

So what should one do, when stock markets are falling and doomsday scenarios are being predicted?

It actually depends on the time horizon that you have with respect to your financial goals.

For financial goals that are at least five-seven years away — stock sales should be used as buying opportunities to add to your existing portfolio.

It would be a good idea to use index funds or diversified equity funds with good track records to build this exposure. In case you already have SIPs running in quality funds, consider adding exposure to the funds to average down your purchase costs.

Remember, that despite all the trying conditions, that we have seen in India over the last decade, the Sensex has delivered an annualised return in excess of 15 per cent over the last 10 years and a very large number of funds have delivered returns in excess of 20 per cent per year.

For financial goals that are less than five years away — If the goals can be compromised/moved ahead like a planned foreign holiday, any other discretionarygoal — you could stay invested or even consider adding exposure to stocks as the case may be.

However, in case the timeframe cannot be compromised, for example a planned education or marriage, it may be advisable to reduce equity exposure despite the fact that the equities have corrected significantly and move the monies to fixed income instruments so that the goal is not compromised.

For investors who do not wish to actively manage their portfolios, they could also consider using balanced funds or dynamically managed products for long term goals, wherein the fund manager automatically rebalances the portfolio at periodic intervals.

So the next time you see a sale in the stock market, consider loosening your purse strings.

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Investor dilemma

What should one do, when stock markets are falling and doomsday scenarios are being predicted? Here are three different scenarios:

- If your financial goals are at least five-seven years away, stock sales should be used as buying opportunities to add to your existing portfolio.
- If your financial goals that are less than five years away and can postponed, you could stay invested or even consider adding exposure to stocks as the case may be.
- If your financial goal cannot be compromised, for example a planned education or marriage, it may be advisable to reduce equity exposure.