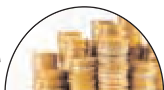
Spread equity porfolio during uncertain times



GET PERSONAL

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TRANSITION

With markets oscillating between jubilation and disappointment, investors need to be careful in converting their equity portfolio to the fixed income portfolio.

- Understand the nature of equity markets
- Separate your tactical equity portfolio from your core equity portfolio
- Align the portfolio with your risk appetite

OVER THE last few weeks, the Indian equity markets have moved down very sharply with a large number of stocks and sectors having lost even more than the index. The mood has changed from extreme optimism to worries about the sustenance of the India growth story on the back of concerns around higher oil prices due to the disturbances in the Middle East, food and commodity inflation, higher interest rates, corporate governance amongst a host of other factors.

Since fixed income returns having also become much higher over the last few weeks with banks raising deposit rates and Fixed Maturity Plans (FMPs) offering the possibility of attractive returns, vis a vis equities that have been consistently losing value, the temptation of moving out from equities lock, stock and barrel and into fixed income is obviously very real.

Whilst it is always tempting to exit from your entire equity portfolio and re-enter at a lower price, the successful implementation of a strategy of this kind of selling higher and buying lower has a very low probability of success.

Fixed income instruments have never worked well as inflation hedges in the past, so a fixed income oriented strategy is unlikely to be appropriate. So what should be done:

■ Equities as an asset class tends to be very volatile over short periods of time. In fact, historical data indicates that equities tend to return negatively over one year periods one third of the time. However, the returns over longer time frames tend to even out. In spite of all the volatility that we have seen over the last many years, the ten year returns on the BSE SENSEX are still in excess of 15 per cent per annum.

If your financial goals are less than three years away, it may be prudent to exit equities in spite of the correction. Ask anyone who bought equities three years ago in the second half of 2007 — the broad markets have delivered close to nothing for the last three years.

■ Markets tend to move between points of extreme pessimism and optimism and as a result can end up being either cheap or expensive. It would be prudent to pare the tactical part of your portfolio during the expensive phases keeping the core intact as returns from equities tend to be concentrated around short periods of time.

Since it is extremely difficult to identify these periods before hand, you do not want to be sitting completely out of equity markets when the markets move up. Similarly, use the periods of extreme pessimism to enhance your tactical exposure to equities.

■ If there are names of stocks and mutual funds that you would not be comfortable with if the markets correct further, pull out of them before you panic sell. Hold the high quality names.

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