ANIMISHA

Say it with STATS

Tired of the current price volatility and market mayhem? Try research tools to arrive at the correct investment decision. **Aman Dhall** reads the fineprint

PICKING winners and avoiding losers is an art that is honed over many years. There is no finishing line and there is no magic formula that work in perpetuity. Take the case of Rajeev Gupta, a steel businessman who started investing in stock markets three years back. The 30-year-old made the most of the bull run on Dalal Street till January this year and earned a big fortune out of the equity markets. A college dropout, Gupta's life was in a fast lane as he became an overnight celebrity in his friends' circle. But post-January crash, Gupta realised that what goes around, comes around. Gupta's portfolio, a combination of penny, small-cap and mid-cap, shed value by 20 times in the next six months. Some of the stocks even got delisted.

Gupta got a lesson of his life — you can't ignore the analysis part while picking up a stock. To make sure you don't commit such a mistake, here's a layman's guide on how to interpret key fundamentals to your advantage.

FIRST THINGS FIRST

For starters, fundamental analysis looks at historical performance data of a company to forecast the future performance. It researches both company specific fundamentals such as dividend yields, earnings, book to market ratio, price earning ratio, working capital, along with macroeconomic data indicators, such as exports and imports, money supply, interest rates, inflation rates, foreign exchange rates. In the words of Nitish Ojha, fund manager (equity), Taurus Asset Management, fundamental analysis is an art of picking good stocks and avoiding bad ones. "The intention is to gain insight into how a listed entity will perform over the short and long term. Though by no stretch of imagination, it's a perfect science," he points out.

Technical analysis, however, uses mathematical time series of historical prices and copious volumes of other statistical models to predict future stock prices. "It is based on the rationale that history will repeat itself and that the correlation between price and volume reveals market behaviour. Prediction of price is made with current price trends and patterns. The most commonly used technical analysis tool is moving average combinations," says Alex Matthew, head of research, Geojit Financial Services. The other commonly used technical tools are oscillators such as stochastic, moving average convergence/ divergence (MACD) and relative strength index (RSI), variances, co-variances, candle sticks, fibonacci series, elliot wave theory and others.

> **INVESTMENT FUNDAS**
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> - While 3, 9 and 18-day simple moving average combination predicts the short-term trends, 200, 100, 50 and 10-day moving averages predict the long-term trends
> - Buying signal happens when the short-term moving average line breaks through the long-term moving average line from down. Selling signal happens when the short-term moving average line breaks through the long-term moving average line from up
> - Efficient market theory holds that in an efficient market, new information is processed and evaluated as it arrives and prices instantaneously adjust to the news and correct levels

DECODING THE MATRIX

While a section of investors swear by fundamental analysis, a sizeable section believes that technical analysis is a better bet to gain insight into future movement of stock prices. "Sharing from my experience, in the long run, I have seen prices almost always revert to the fundamental values. However, in the short run, periods of over reaction or under-reaction are ubiquitous," says Ojha. Matthew, however, thinks that only a combination of fundamental and technical analyses can provide an investor with the right answers. For instance, if an investor wants to invest in equities, he should understand the market dynamics and global factors that can affect the stock market such as inflation, GDP growth, currency movements, apart from other world markets' performance.

Also, he should have a sound back ground and good knowledge of companies and their sector. "For this, ratio analysis comes handy. After you are through with the sector and the stock through fundamental analysis, technical analysis can be incorporated," Matthew elaborates. For example, if you select 'capital goods sector', use the technical analysis and find out the sectors performance through its index known as capital good sector index, which is available on BSE website, www.bseindia.com. If the index is witnessing bullish trends, then you can interpret the stock using technical analysis to find out the entry and exit levels.

GAUGING THE FEAR

With the market on a downturn and volatility high, analysts consider that as investors, it is pertinent to track the volatility index of Nifty and CBOE volatility index, which provide a much clear picture of the market. For the uninitiated, if the volatility is above 30%, then the market is said to be very fragile in nature, above 40%, then one can expect uncertain market conditions and if the volatility index is above 50%, it can be dangerous. If the volatility is less than 20%, it is good for buying stocks.

If you diligently follow the above processes and innovate along the way, more often than not, you will be able to make realistic assumptions of the future performance of the company and the inevitable corresponding price movement of stock prices.

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WEEK AHEAD

SUDIP BANDYOPADHYAY

Normalcy may take more time

Maynard Keynes is alleged to have said: "When the facts change, I change my mind." Investors and lenders have moved from trusting anybody to trusting nobody. The fear driving today's breakdown in financial markets is as exaggerated as the greed that drove the opposite behaviour a little while ago. But unjustified panic also causes devastation. It must be halted, not next week, but right now. The time for institution-by-institution and country-by-country approach is over. It took the regulators time realise the full dangers. Maybe it was errors at the US Treasury, particularly the decision to let Lehman fail, that triggered today's panic.

First of all, the panic must be dealt with. This has already persuaded some governments to provide full or partial guarantees of liabilities. These guarantees distort competition. Once granted, however, they cannot be withdrawn until the crisis is over. So European countries should now offer a time limited guarantee (maybe six months) of the bulk of the liabilities of systematically important institutions. In the US, however, with its huge number of banks, such a guarantee is neither feasible nor necessary. This time-limited guarantee should encourage financial institutions to lend to one another. If it does not do so, central banks must lend freely, even on an unsecured basis, to institutions too systematically significant to be allowed to fail. By these means, the flow of credit should restart. But governments cannot allow banks to gamble freely with the public money. During the period of the guarantee, governments must exercise close oversight over the institutions they have decided to protect.

Meanwhile, India must be careful to draw the right lessons from the US crisis. Liberal finance is not a bad thing in itself, but certain bits of the system need tinkering. For one, the role of credit rating agencies, somehow not highlighted in the midst of this crisis, needs to be critically looked at by regulators. Second, we must understand that while financial inclusion is a good thing, too much of it, too fast may be counter-productive. This is not to argue that everyone should not have access to a bank account: they certainly should. But banks and financial institutions need to be more prudent in giving too much credit to high risk borrowers. Third, policy makers must keep track of asset bubbles, usually a common occurrence in times of excess liquidity, and disincetivise bubbles. This is tough to do and carries the risk of over correction. But regulators should start thinking about broad guidelines.

> "The markets have broken all support levels and are in a totally different orbit as far as downside is concerned"

Global pain in the US and European financial markets during this week had a disastrous fallout on the Indian markets which was reflective of a new 52-week low for both the Nifty and the Sensex. Moving swiftly RBI, announced two quick CRR cuts — which will further infuse fresh liquidity.

On the domestic macro front while crude prices continued to soften further and dropped below the $80 per barrel level and Inflation numbers for this week also continuing to moderate on the lower side to 11.80%, the news on the IIP numbers front for the month of August 2008 was extremely shocking. IIP growth for August, 2008 recorded a growth of just 1.3% against a consensus estimate of 5.5%, and compared to last year corresponding month number of 10.9% which is the lowest since October 1998. Reflecting the weak macro environment both globally and for India, IMF has cut its world growth forecast to 3% from 3.9% earlier and downgraded India's GDP growth this year to 6.9% from 7.4% estimated earlier. The rupee also witnessed a fall of 3% to touch a high of Rs 49.30 per $ this week which is the biggest weekly decline since November 1997. In fact one has observed a total dollar outflow of $7.9 billion during this week which is the single biggest outflow seen till date with cumulative foreign exchange reserves standing at $283.94 billion as on date.

The markets have broken all earlier support levels and now are in a totally different orbit as far as downside is concerned. The market sentiment has been badly hurt by the continued FII unwinding seen till date and 'fear factor' has now clearly gripped the markets resulting in panic selling across the board. Markets may take some more time to stabilise and for normalcy to return. Nervousness is likely to continue this week. However, the oversold status of the markets may give some intermittent bounce back rallies, which could be used by panic struck institutional investors or hedge funds for further offloading.

The writer is CEO, Reliance Money

Top 3 ELSS Funds

Scheme Name	NAV (Rs)	Last 1 Week (%)
Sundaram PNB Paribas Taxsaver (Open Ended)- growth	26.15	-8.80
UTI Long term Advantage Fund Series II- Growth	7.74	-9.15
Lotus India Agile Tax Fund-Growth	5.68	-9.55

FUND WATCH

Top 3 ETFs

Scheme Name	NAV (Rs)	Last 1 Week (%)
Quantum Gold Exchange Traded Fund-Growth	718.33	13.19
UTI Gold Exchange Traded Fund	1441.58	13.12
Kotak Gold Exchange Traded Fund	1441.99	13.10

SOURCE: www.mutualfundsindia.com

MONEY MANTRA

Bogged down by market turmoil and don't have a clue how to manage your investments? SundayET has tied up with top financial planners to take care of all your worries. Just write in to our panel of experts at
moneyandu@indiatimes.com

INCOME EARNED ABROAD & TAX

A resident Indian has ESOPs allotted to him by his employer which are traded only on Nasdaq. He will be liable for capital gains if he exercises the option and sells them now. Will the gains be taxable as other income?

SUDHA JAYARAM

In case of a resident Indian (presuming the residential status is resident and ordinarily resident), the gain arising on sale of shares allotted under employee stock option plan (ESOP) would be taxable under the head 'income from capital gains' in the hands of the tax payer. The nature of the capital gains — whether short-term or long-term — would depend upon the period of holding of said shares. If the shares are held for not more than 12 months, short-term capital gains would arise; else long term capital gains would arise. Also, levy of capital gains would have to be examined vis-à-vis levy of fringe benefit tax, based on facts of the case.

UNEXPLAINED DEPOSIT IN BANK

A friend's family transferred money to my account (Rs 1 lakh) so that I could hand over the money to my friend who doesn't have an account. Is this ok? Will I be questioned by tax officials?

ANONYMOUS

If your tax return is picked up for assessment (revenue audit), you may have to explain the above debit and credits to the tax authorities along with documentary evidence. You may also be required to substantiate that this is not your 'income', per se. Therefore, it may be advisable to open a bank account for the beneficiaries of your friend and remittances made directly into that bank account, to avoid any dispute at a later stage.

TAX TREATMENT OF HRA & LOAN

I bought a flat in Bangalore. The flat has been given for rent whereas I stay in a rented house. Can you please tell if I can benefit from the housing loan I took to purchase the above flat? I do not own any other residential property. My company did not consider my housing loan as well as HRA that I paid for the house on rent. They said that they will consider only one, either HRA or housing loan (Rs 1.5 lakh benefit if I stay in my own flat). Please advise.

PARTHA

As per provisions of the Income-tax Act, 1961 (the Act), an exemption can be claimed by the taxpayer for the rent paid in respect of an accommodation (not owned by him) occupied for his residential purpose, subject to certain conditions. In respect of the let-out house property, a deduction of the interest payable on the housing loan can be claimed by the taxpayer under the head 'income from house property' (actual interest without any upper limit). Further, a deduction under section 80C of the Act is available in respect of the principal re-payment of the housing loan (maximum up to Rs 1 lakh). Based on the facts of the instant case, you can claim the HRA exemption for the rent paid by you, to the extent permissible under the Act. Also, you are eligible to claim the deduction for the interest paid on the housing loan (from annual value of the let-out flat) along with the deduction of the principle repaid under section 80C of the Act.

VIKAS VASAL, PARTNER, KPMG INDIA

(These comments are based on the limited information provided by the investors. The advice may vary subject to actual facts and circumstances of the case)

Let your investment strategy decide mutual fund choice

Ringside VIEW

Shruti Jain
Senior vice-president
Arihant Capital Markets

PICKING the right mutual fund out of more than 3,000 options in the market can be really tough. But if you decide your investment strategy and fit it to your personal goals, things get much simpler. A mutual fund scheme's investment strategy describes the fund manager's approach to building a portfolio. Most equity mutual funds fall into one of the three categories: index funds, actively managed funds and enhanced index funds. Within each strategy there are a wide range of options.

UNDERSTANDING THE DIFFERENCE

Index fund managers attempt to replicate the performance of a benchmark index, say BSE's Sensex or NSE's S&P CNX Nifty, by creating a portfolio that mirrors the composition of the chosen index. In other words, there is no effort to beat the index, merely to earn the same return. Index funds are also called passive funds due to their passive investing style. Active fund managers seek to outperform the market as a whole and attempt to meet this goal with a combination of smart stock picking, market timing and asset allocation decisions. Enhanced index funds, not a commonly used term, fall somewhere in between the two. They aim to track an index, but also attempt to generate higher-than-market returns by straying from the index in order to take advantage of market timing, specific stock selections, and/or leverage. See the chart for a brief summary of all the three types of funds.

FITTING INTO YOUR PERSONAL GOALS

As with any financial decision, choosing an investment strategy largely depends on your personal goals, as well as other considerations, including the asset class you're investing in, fund management and operating costs, interest in tax efficiency and your risk tolerance. And you have plenty of choice. The mutual fund industry in India is still in a nascent stage, and new schemes are being launched almost by the day. Given the perplexing array of funds and schemes to choose from, it's imperative that you understand what suits you best and what will meet your financial goals.

Your choice of investment strategy may depend on your perception of the financial markets. The two common market perceptions are whether the markets are 'efficient' or 'inefficient'. This is an age-old debate in which proponents of efficient market theory argue that prices fully reflect all the available information on a particular stock and/ or market and hence no investor has an advantage in predicting a return on a stock price because no one has access to information not already available to everyone else. So when markets are perceived as efficient, it becomes harder and nearly impossible to beat the market. Index funds and enhanced index funds can be smart choices if you think the markets

are efficient and because they seek to offer performance similar to the market average and in the long run returns from the markets will be higher than any active management.

In contrast, in an inefficient market, some securities will be overpriced and others will be underpriced and fund managers may be able to gather information through their research and analysis that is not widely available to the public and be able to outperform the market average. Consequently you may favour actively managed funds if you think that markets are inefficient.

Most markets, particularly Indian markets, are inefficient and skilled fund managers have the potential to add genuine value for investors. The more inefficient a market is, the easier it may be for skilled active managers to outperform the particular market as a whole. Financial markets of developed countries are more efficient than those of developing economies and hence in India, the opportunity to outperform the markets are greater, which is also reflected in the performance of active funds vis-à-vis index funds.

In addition to your personal view about whether the markets are efficient or inefficient, it's important to make decisions in the context of your long-term financial plan. So consider all your options before choosing a particular investment strategy.

MAKING THE RIGHT CHOICE

Choosing an investment strategy is largely a matter of making informed decisions, with few right or wrong answers. Identifying the strategies that is best aligned with your personal goals is a smart way to keep your financial plan on track. You can also benefit from including different investment strategies in your portfolios. The key is to stay focused on your long-term goals and choosing your investment strategies accordingly. And it is imperative to understand that if you invest in equity your investment horizon should be at least three years as equity funds are not advisable for short term.