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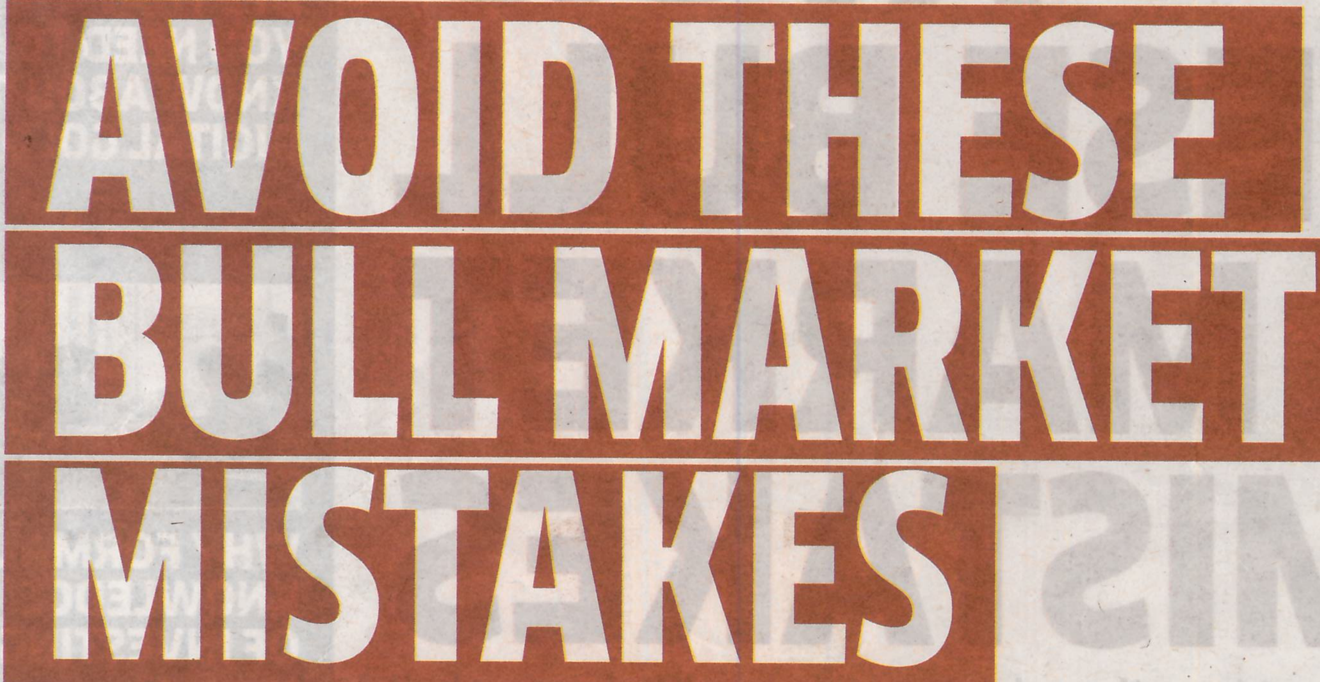


AVOID THESE BULL MARKET MISTAKES

The worst investing mistakes are committed during bull markets. Find out how to avoid making these errors.

By Narendra Nathan

Equity markets are filled with exuberance. Existing investors are assuming that the recent historical returns will be repeated, while a new set of investors is getting ready to jump in, lured by the high returns earned by their friends and relatives. But retail investors commit their worst mistakes during bull markets like these. We reached out to the investment experts to know the most common mistakes and how one can avoid these investing errors.

Chasing high-priced IPOs

Investors are flocking to the IPO market, without realising that the secondary and primary markets are two sides of the same coin. Many companies are using the bullishness in the secondary market to raise money through the primary market. Experts say big IPOs usually come at the advanced stage of a bull market. "The IPO pipeline is going strong. About ₹40,000 crore is expected to be raised in the next 2-3 months," says

Pranav Haldea, Managing Director, Prime Database.

The bullishness is helping issuers sell their holdings at high prices. "Investment bankers price IPOs to the maximum and leave very little on the table for the investors," says Mayank Khemka, CIO-India, Deutsche Bank. So, should you avoid the IPO market now? Not really. "Don't avoid all IPOs. Some good issues also come in overheated markets like these," says Naveen Kulkarni, CIO, Axis Securities.

But you do need to be extra careful because investors have lost money in low quality and high-priced IPOs in recent months (*see table*). How can investors pick the winners and avoid the losers? First, see who is running the book and invest only in IPOs from top-notch merchant bankers. Second, avoid issues where the money is not being raised for the business, but by promoters or early investors by reducing their holdings. Third, avoid companies with high debt.

"Corporate governance is very important. Investors should avoid IPOs from promoters who have delisted their companies earlier at lower prices and coming back with IPOs at higher prices," says Daljeet Singh Kohli, CIO, *StockAxis.com*.

Investors should also compare valuations with listed companies from same industry. However, this is difficult when the issue is of unique players such as Zomato or Paytm.

Falling into the NFO trap

Just like companies are using the bull market to get maximum valuations for their IPOs, mutual funds are launching NFOs to collect the maximum amount. "This asset gathering mode of fund houses is not in the investors' interest," says Melvin Joseph, Managing Partner, Finvin Financial Planners. Since informed investors know that NFOs are similar to the existing schemes, these NFOs are directed at new and lay investors.

It is best to avoid an NFO if there is already a similar scheme with a track record. Go for it only if it is a new or unique theme and if you understand how it will work. For example, investors had no idea how the quant model of the Tata Quant Fund will work at the time of the NFO in January 2020. The fund turned out to be a disaster (*see chart*). Though these models are based on historical analysis, there is no guarantee that they will work in future. Also, the restricted mandate means the fund manager is not able to do course correction. Investors should also avoid NFOs ike Bharat-22 which are designed by the seller for the seller.

Buying the hot sectors

Investors start buying stocks after they become hot. But they also pour money into mutual funds that have done well in the past. This is especially true of sector-focused funds. Since sector or thematic schemes tend to be volatile, some of them will always be among the top gainers. "Ideally, investors should invest in a sector or theme which has not done well but is expected to recover in reasonable time–this is like mean reversion. However, most investors do the opposite," says Tanwir Alam, Founder & CEO, Fincart. For instance, pharma sector funds that are now the darlings were generating negative returns a few years back. (*see graphic*).

Sector or thematic schemes are meant for informed investors. Just like the entry, investors also need to time their exit. It is best to avoid sector or thematic funds now because most sectors and themes are red hot now. Even otherwise, such funds are not suited for investors who want to hold for the long term. "Sectoral performance averages out over the long term. So, it makes sense to go with diversified funds," says Joseph.

Betting on concentrated portfolios

Many new investors may not know of the modern portfolio theory and therefore invest only in a few select stocks. Since concentrated portfolios are more volatile and we are in the middle of a raging bull market, they must be enjoying the ride. But experts say diversification is the key to equity investing. "Having a well diversified portfolio is very important, especially when the equity market risk is high like now," says Vinay Khattar, Senior VP and Head of Research, Edelweiss Securities.

A concentrated portfolio can hit you badly when the market turns its direction. Even professional fund managers find it difficult to manage concentrated portfolios. The equity market has witnessed extreme polarisation in the past few years. Yet, the JM Core 11 Fund, which has a concentrated portfolio of only 11 stocks, has underperformed its benchmark for the past two years. Experts say you need more stocks for proper diversification. "Around 20 stocks are enough to create a well diversified stock portfolio and reduce the risk," says Nikhil Kamath, Co-Founder & CIO, Zerodha.

Shifting completely from funds to direct stocks

After they make money in bull markets, some investors start thinking that they can beat experienced fund managers and shift their fund portfolios to direct stocks. The sudden spurt in number of demat accounts (*see graphic*) is a testimony of this. But this can be a grave mistake. "Never misunderstand the bull market successes as your investment skill. Bull market will be followed by bear markets and that will be the real test," says Khattar.

These high-priced IPOs destroyed wealth

The primary market can be riskier than investing in the secondary market

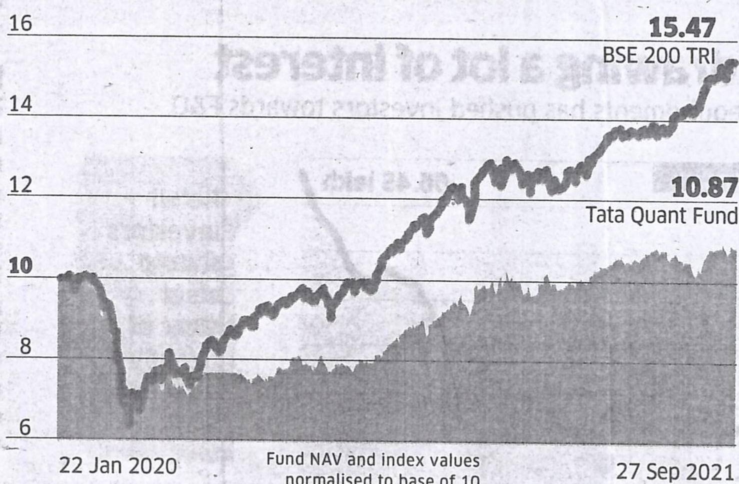
LISTING DATE	COMPANY	ADJ. IPO PRICE (₹)	CURRENT PRICE (₹)	% LOSS
18 Dec 2017	Future Supply Chain Solutions	664	69.70	-89.50
18 Sep 2017	Bharat Road Network	205	29.40	-85.66
9 May 2017	S Chand and Company	670	114.25	-82.95
31 Mar 2017	CL Educate	502	138.20	-72.47
6 Jul 2018	Varroc Engineering	967	289.50	-70.06
14 Nov 2017	Khadim India	750	228.50	-69.53
25 Oct 2017	General Insurance Corp. of India	456	145.45	-68.10
13 Nov 2017	The New India Assurance Com.	400	162.00	-59.50
22 Jan 2018	Apollo Micro Systems	275	116.85	-57.51
22 Sep 2017	Reliance Home Finance	10	4.25	-57.50

Data as on 24 Sept 2021

There is a greater chance of high-priced and low quality IPOs during bull markets.

Fancy funds don't always add value

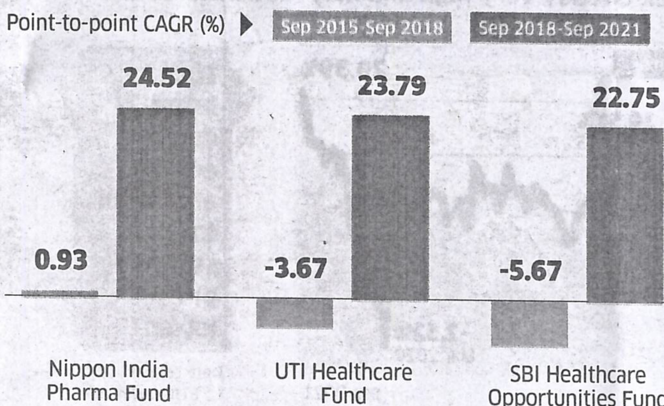
The Tata Quant Fund launched in January 2020 has underperformed



Avoid NFOs and invest only in schemes with clear track record.

Sector funds are volatile, not for everyone

Pharma funds are doing well now but were down in the dumps three years ago.



instead of chasing hot sectors, buy those that are down but likely to do well later.

Source: Value Research

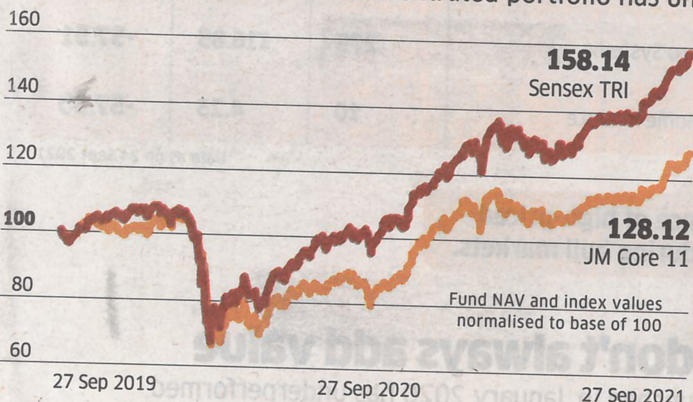
Investors are taking to stocks in a big way

Number of new demat accounts has shot up in the past 18 months

Figures are new CDSL and NSDL demat accounts in lakhs

Concentrated portfolios can be risky

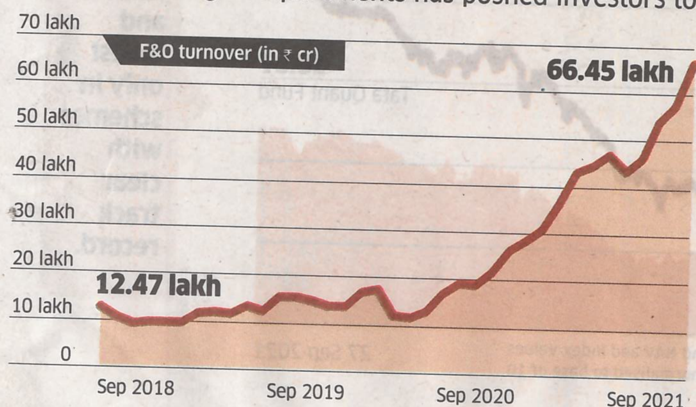
The JM Core 11 fund with a concentrated portfolio has underperformed.



It is always best to diversify your stocks portfolio to reduce risk.

F&O is also drawing a lot of interest

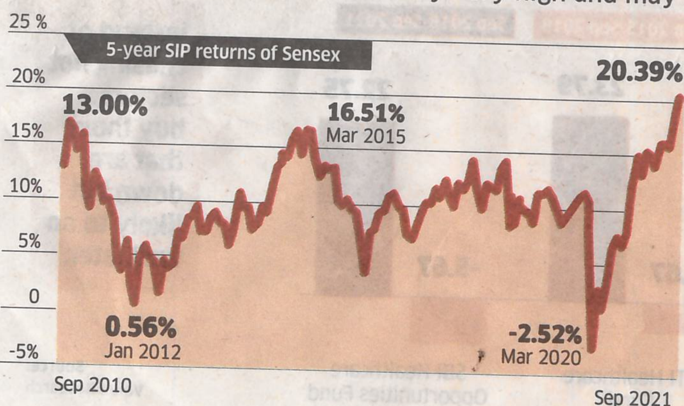
The hike in margin requirements has pushed investors towards F&O.



Retail investors should steer clear of this ultra high risk segment.

Future returns may not match the past

5-year SIP returns of Sensex already very high and may moderate now.



Time to bring down equity allocation to preset level or even lower.

Data compiled by ETIG Database

Even investors who shift small portion to direct stocks need to be cautious. This is applicable even for investors who did this a few months back and made a lot of money from direct stocks. "In the advanced stages of bull markets, which we are in, some investors get carried away and start investing in lower quality stocks," says K. Sandeep Nayak, CEO, Centrum Broking. This can backfire because most stocks are already highly valued. Your understanding of the sector and stock need to be superior to make further money. "Since investors are now buying at higher valuation, they should invest only in high quality stocks now," says Kamath. "Avoid companies with promoter issues, increasing debt or low return on equity," says Kulkarni.

Resort to leveraged trading and intra-day investing

Emboldened by their successes, some investors are also getting into the highly risky arena of derivatives and day trading. They are also lured by the success stories of other day traders. Most of this is margin trading, where the investor puts a small margin and the broker allows him to buy stocks worth 4-5 times that amount. Sebi has increased the margin requirements for day trading, so the trading interest in futures and options (F&O) segment has shot up.

While intensive stock trading will benefit brokers, these leveraged trades are very high risk games and new investors should stay away from them. "Unlike normal businesses, volatility is very high in the equity market and this increase the chance your forced exits," warns Khattar. For example, assume that you invest ₹1 lakh and buy stocks worth ₹5 lakh. Though your initial capital is only ₹1 lakh the gains and losses you make will be on ₹5 lakh and your broker will close your position if there is a sudden 20% fall in that counter, which is normal in equity markets.

Since the market is already at higher levels, experts say that even seasoned traders should reduce their leverage. "Emboldened by their earlier success, traders tend to increase their leverage and this will be a big mistake. In fact, they should unwind the leverage in the advance stages of bull market like now," says Nayak of Centrum Broking.

Not booking partial profits in a bull market

A common mistake of retail investors is not booking partial profit in a runaway bull market. "Though market may go up further and this will result in some notional loss, it is not a big worry," says Nayak. As they say, 'no one ever went broke taking profits'. However, very few people are able to implement it because as the markets rise, the risk perception of the individual undergoes a change. Change in the risk profile is a common phenomenon during bull and bear markets. The same person who avoided risk during bear markets usually takes high risk during bull markets due to high historical returns. For instance, 5-year SIP returns are already above 20% mark (*see graphic*). It will be foolish to expect similar returns in the coming years.

Though experts ask investors to be greedy in bear markets and fearful in bull markets, most investors do exactly the opposite. "Due to short memory, most people have forgotten about the March 2020 crisis. Some investors, who are about to retire in a few years, are holding on to equity despite its proportion crossing 80% and are also making fresh investments," says Joseph.

This optimism can have grave consequences. Such investors should sell part of their equity holdings and shift that amount to the safety of fixed income. Making new investments in debt and bringing down the equity portion is a better strategy because there won't be any tax incidence due to this rejigging.

This increased debt allocation now will also help you to increase equity at the appropriate time. "While it is important to ride the current bull wave, investors should not get carried away and take aggressive bets. Since everything is expensive now, wait for market corrections to deploy fresh allocations," says Khattar.

Exit the equity market completely

What experts advise right now is to reset to your preset asset allocation or even a bit lower than that using tactical allocation. You can also fast track this equity allocation reduction in special situations. "Since equity has already generated good returns, investors can speed up the equity reduction if any major goal is coming within the next five years," says Joseph.

However, there is also a flipside of playing it too safe. Just like not booking partial profit is one mistake, getting fully out of the market due to valuation concerns can also prove counter-productive. "Don't get out of the market now because the long-term India growth story is still intact and market should also do well because of good Indian entrepreneurship quality," says Alam.

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