Basics of stock investing
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Many of us are highly suspicious of the stock market. Those who have little idea about what it is see it as some form of gamble. Everyone seems to know about someone who has lost his shirt in the stock market and has thus concluded that investing in stocks is the short cut to financial ruins. Of course, there are many who have made a fortune in the market, but their success is seen as a miracle or something that has happened by fluke. All in all, the average person is confused about the stock market and doesn’t want to understand it either.

This supplement to the anniversary issue of *Wealth Insight* is an effort to introduce you to the basics of stock investing. While the field of stock investing is very wide, this short book will give you a crisp summary of all it takes to invest in stocks. After going through this book, you can pick some classic texts on stock investing and continue your study of it. A few books are mentioned in a later chapter of this supplement. Like any other field, mastery in stock investing comes when you commit to becoming a life-long learner of it. Not surprisingly, all renowned stock investors are also avid readers and learners.

To start, let’s see what stock investing isn’t. Stock investing isn’t about making quick gains in the short term; that’s stock trading. Traders have a different approach to the stock market. They employ leverage to enhance their gains in the short term. Derivatives (futures and options) are the tools of leverage in the stock market. As a stock investor, you must stay away from them. Those who make huge losses in the stock market are generally those who trade in the stock market. As a stock investor, you have higher odds of emerging out as a winner.

The stock market is a channel to invest in businesses and prosper with them. In a capitalist economy, businesses are the engines of economic growth. Now most of us may not want to start a business. How do we then become a partner in economic growth? The answer is through the stock market. Many companies, big and small, trade on the market and you can buy their shares. Shares are nothing but ownership interests in businesses. Technically, you become part owner of the business. If the business does well, the stock will appreciate. That’s what stock investing is at its core. Nothing more, nothing less.

What scares people is market volatility – the ups and downs of the market. In the short term, the market may look difficult to navigate, but in the long term (five years or more) what eventually gets rewarded is how well the business has done over time. This means that if you are invested in good businesses over the long term, you can make serious money. Here is one caveat: mind the valuations.

The three phrases that you must engrave in your mind are: good businesses, right valuations and long-term focus. Ignore short-term volatility and base your investment decisions on these principles.

Paying too much for even a good business is a losing strategy. So the three phrases that you must engrave in your mind are: good businesses, right valuations and long-term focus. Ignore short-term volatility and base your investment decisions on these principles.

Coming to the procedural part, you need to have a trading and a demat account to buy and sell shares. You can contact a stock broker and he will advise you how to open such an account. Many banks also provide brokerage services. Brokers also try to sell investment products to you. They also give you stock advice and tips. Don’t fall for them. Always base your investment decisions on your own analysis. That’s how you can profit from stocks.
Stocks compete with many other asset classes, starting from a rudimentary bank account to other advanced asset classes like currency futures. While diversification across asset classes is a good idea, no other asset class is more rewarding than equity.

Bank deposits and debt instruments (bonds and bond funds, Public Provident Fund, post-office deposits, etc.) give fixed returns and hence look safer than stocks, which can be highly volatile. Debt instruments were previous generation’s pet. Many of us still vouch by the sanctity of fixed income. The only problem is that you can’t create wealth with debt. If you account for inflation and taxes, you may actually be losing money on it.

The main difference between debt and equity is that while the former stands for ‘lending’, the latter means ‘ownership’. By investing in a debt instrument, you are effectively lending money to the debt issuer on interest. When you lend money, you can’t expect to earn more than the interest rate. But when you invest in stocks, you become part owner of the business. If the business does well, your returns have no upper limit. Stock investments are a bet on the economy. If the economy is going to grow, stock investments, in general, should grow by that much rate. Good businesses can do even better than the economy and hence multiply your money manifold, something you can’t expect debt investments to do.

For many Indians, real estate is the most ‘respectable’ investment. Don’t fall for the stories that magnify returns from property, for they are flawed. Equities trump real estate on many counts: returns, ease of handling, transparency, tax treatment, liquidity, etc. Apart from these, real-estate investments often require large sums. Since most people don’t have any idea about how to invest in real estate, betting with large sums could be highly risky.

Indians’ love for gold has made them infamous in the world. While the use of gold as jewellery is still understandable, gold as an investment remains questionable. You earn no dividends from it; on the contrary, you need to spend on its storage if you hold it in physical form. Gold returns have been sluggish overall. The metal is also to be blamed for the country’s fiscal deficit because the country has to import it to satisfy Indians’ insatiable appetite for it. No wonder the government has launched schemes to limit hoarding of gold. A lot of black money also sits in gold.

Analysing commodities, such as metals, oil and agriculture products, requires special knowledge and access to their supply-demand trends, which are not readily available. Even if they are, the data are generally old. To be sure, commodity derivatives are more suited as a hedging instrument than an investment tool. The producers and sellers of those commodities use derivatives to protect themselves from future risks. For the individual investor, dealing in derivatives is complex and risky. They can give you deep losses before you realise what’s going on. Ditto with currency futures. They are complex, derivative-oriented products that should best be left to traders.

All this suggests that one should seriously consider equity investments for wealth creation. If picked well, stocks can do wonders beyond your imagination.
How to make money in the stock market? This is a classic question that most investors ask. And the answer to this question depends upon whom you are asking. There are a number of styles of stock investing and their adherents vouch for the efficacy of their respective styles. How do you know then which style is good? Here is some quick help.

Broadly, all styles of stock investing can be categorised into two: fundamental investing and technical investing. While a fundamental investor studies financial details and other company-related information to pick his stocks, a technical investor studies price patterns, trends, mathematical models and other graphical data to pick stocks.

Which of these two is better? We profess fundamental investing. The technical style of investing is mostly used by traders to make a quick buck in the market. It is not just complex but also not suited to most investors. Neither is its wealth-creation track record impressive.

The fundamental style of investing can itself be divided into many sub-styles. Since it entails studying a company’s financial data and other company- or sector- or economy-related information, a fundamental investor can use a combination of these to formulate his ‘own’ stock-investing style. For instance, an investor may give more weightage to certain financial parameters and club them with his subjective judgement of the sector dynamics to pick a stock.

Though the styles of fundamental investing are many, the more popular ones are growth investing and value investing. Growth investing seeks to invest in those companies that have ample room to grow and expand. Such companies tend to belong to booming industries. Think of the information-technology sector in the last decade. Indian IT companies were growing at a feverish pace. They were the most sought-after by investors. Given their ‘privileged’ status, growth stocks command a premium and are available at high valuations.

Value investing, on the other hand, is about spotting companies which are available at a ‘bargain’. What’s a bargain? Value companies are available at less than their intrinsic worth. An analogy for this is how people shop for vegetables. You check many stalls, locate the freshest veggies, ask the price, and if the price looks high, tell the vendor how much you are ready to pay.

Value investing is the real form of investing. It requires you to find good companies available at a bargain. Why are they at a bargain if they are really good? The stock market chases the fashion of the day. Those stocks that get ‘out of fashion’ are ignored by the market. And that’s exactly why you should pick the best among them. Such stocks are available at a bargain. Later when the market recognises their potential, they get rerated and deliver gains.

Value investing is not just a logical way of investing in businesses, it’s also comparatively ‘safer’. You buy stocks at low valuations and this acts as a safety net if the market itself falls. In market declines, expensively valued growth stocks tend to correct heavily and can give investors sleepless nights.

Value investing is essentially long-term investing as the realisation of value happens over the long term. This is why you should have a time horizon of at least five years when you invest in stocks.
A company’s financial statements are a window into its financial health. No wonder studying them is an integral part of fundamental analysis. While analysts dig deeper into financial statements and try to unearth the not-so-obvious aspects of a company’s financials, for an investor, understanding basic financial statements should suffice in most cases.

There are three major financial statements: the balance sheet, profit-and-loss statement and cash-flow statement. The balance sheet tells you about the assets and liabilities of a company. The profit-and-loss statement tells you about a company’s profitability. And the cash-flow statement is about the flow of cash into and out of the company.

**Balance sheet**
The balance sheet is called so because it always balances according to this relation:

\[
\text{Assets} = \text{Liabilities} + \text{Owners’ equity}
\]

A balance sheet that doesn’t balance is simply wrong. The balance sheet shows the assets that a business owns, the liabilities that it owes and the funds contributed by its shareholders. Assets include land, equipment, inventory, goodwill, patents, brand value, etc. Liabilities include debt (long term and short term) and any other payables that a business has. Shareholder funds are in form of equity and reserves.

A weak balance sheet is one that is saddled with debt. When a business has a strong balance sheet, it has more assets and equity than liabilities. In order to know the balance-sheet strength, you need not actually see the balance sheet; you can just look at the debt-equity ratio. What’s that? More on it soon.

**Profit-and-loss statement**
As its name suggests, the P&L statement tells you about the profitability of a company. The simple formula to calculate profits is as follows:

\[
\text{Profit (loss)} = \text{Revenue} – \text{Expenses}
\]

The head ‘revenue’ generally has two entries: revenue from sales and other income. Other income is the revenue from the sources other than the core area of the company’s operations. For instance, it could be income from investments, dividends, royalties, etc.

The head ‘expenses’ constitutes the categories of expenditure such as cost of raw materials, employee costs, etc. On subtracting the total costs from the total revenues, we get the ‘operating profit’, which is nothing but a company’s profit from its core operations.

In order to arrive at the final profit figure, any miscellaneous income or loss is to be added to or subtracted from the operating profit. Finally, net profit is obtained after deducting the tax applicable.

**Cash-flow statement**
The cash-flow statement shows the movement of cash in a business. While businesses can misstate their profits through accounting jugglery, they can’t fudge the movement of hard cash. Hence, a cash-flow statement provides a true picture of a company’s financial health. However, for banks and finance companies, the cash-flow statement is of limited use as these businesses have a different business model than other types of businesses.

The cash-flow statement has three components: cash flows from operating activities, from financing activities and from investing activities. The statement also mentions the current cash holding of the business.

What you need to see among these data is whether the flows from operating activities are positive or not. If they are positive, it means that the company is able to generate cash from its operations. If they are negative, it means that the company is losing money.
While it may show profits in its P&L statement, negative flows from operations should ring an alarm. Cash flows from financing activities show the money raised for the company’s operations or the money paid towards debt repayment. The former will be a positive number on the statement, while the latter will be a negative number.

Cash flows from investing activities capture the cash used in investments. For instance, a business that has generated surplus cash may park it in a bank fixed deposit. Next year it may withdraw cash from that FD. The former will be a negative number on the statement, while the latter will be a positive number.

Financial ratios
If you are not one who likes to dig deep into a company’s financial statements but still wants to make sense of its financials, financial ratios come to your rescue. They are readymade tools to interpret what’s happening in a company. Most financial ratios can be derived from the three major financial statements: balance sheet, profit-and-loss statement and cash-flow statement.

In order to put a company’s ratios in perspective, compare them with the industry trend and peers’ ratios. Again, good analysis goes beyond ratios, and you shouldn’t make your investment decision just in terms of ratios.

Here is a summary of the major financial ratios and what they mean. You can find these (and more) for any Indian listed company on the Value Research website. Just type in a company’s name in the search bar. On the company page, click on the ‘Financials - Annual’ tab and scroll down. You will find the ‘Key Ratios’ section, as shown in the screenshot alongside.

**Debt to equity:** Companies take debt to run their business operations. Their shareholders also put money, called equity, in the business. The debt-to-equity ratio tells us about this balance. A high debt-to-equity is not desirable. But to know what is ideal, you must see the industry-wide trend. As a rule of thumb, avoid companies where the debt-equity ratio exceeds one.

**Return on net worth (RONW):** Also called the return on equity (ROE), this ratio tells us what returns a company is generating on its equity part. A high RONW is desirable. Good companies have more RONW than their peers.

**Operating margin:** This ratio tells us how much a company makes from its core operations. It is derived by dividing the operating profit by the total revenues. A high operating margin is a good sign, but do see the industry trend.

**Revenue growth:** This ratio indicates how fast a company is growing its revenues over a period of time. A high revenue growth is a positive sign and shows that the company is expanding.

**EPS growth:** This is a tool related to earnings and tells us the growth of earnings per share (EPS) over a period of time. For instance, if the EPS of a company this year has gone up from ₹10 to ₹12, the EPS growth is 20 per cent. Good companies show higher earnings growth than their peers in a sector. A shrinking EPS, on the other hand, should ring an alarm.

Good analysis goes beyond ratios, and you shouldn’t make your investment decision just in terms of ratios.
Assessing the business

Assessing a business lies at the heart of stock investing. Behind every stock is a business and the fortunes of the stock are closely tied to the fortunes of the business. If a business does well, it’s highly likely that the stock will also do well.

Assessing a business is not something that can be covered in one page; there are full books available on this subject. The objective here is to give you a quick primer on what all it takes to assess a business. It requires both skill and experience to do so.

Business assessment can be broadly divided into two categories: quantitative and qualitative assessment. While quantitative assessment focuses on financial data, qualitative assessment looks at other non-data factors such as management quality, industry outlook, product appeal and so on.

Qualitative assessment can take many forms and it is a function of one’s experience in the field. Experienced investors can read the business environment much more accurately than a novice can. Here are some other factors that one must check in qualitative analysis:

**Scalability of business:** A scalable business is one that can be extended and expanded. For instance, consider the market for consumer goods. As the market grows, demand for consumer goods automatically increases.

**Strength of the brand:** An established brand doesn’t require much pushing; the products keep flying off the shelves on their own. Take the case of Maruti Suzuki. Maruti is a go-to name in the car segment. It’s known for its wide distribution and affordable cars.

**Presence of an impenetrable moat:** A moat is a strategic advantage that a company has over others. A moat also means high barrier to entry. Consider Larsen & Toubro. The company has unparalleled expertise and capability to execute infrastructure projects that no other company can match. Hence, it has a moat.

**Industry outlook:** A business could be an outlier in its industry but it’s never insulated from the industry-specific headwinds and competition. The sorry state of the Indian telecom sector means that even the largest player Bharti Airtel has been a disappointment for its investors.

**Complexity of the business:** How easy is it to understand what the company does? For instance, most people will have trouble understanding the intricacies of the software business. But understanding what ITC does is quite easy.

While quantitative assessment focuses on financial data, qualitative assessment looks at other non-data factors such as management quality, industry outlook, product appeal and so on.

**Overall image of the company:** How is the company perceived? Do people complain of its products? Is the company battling multiple court cases? How aggressive is it? Paying attention to the overall image of a company helps as it is generally a sum total of all that is going on with it.

**Evaluating the management**

The performance of a company is a direct function of the competence of its management. A shady management can destroy shareholder wealth by engaging in unscrupulous activities. On the other hand, a competent management can sail the company
through tough times. Companies with competent managements are true wealth creators.

Many investors don’t realise the importance of evaluating the management unless some crisis breaks out. But how do you go about assessing a management’s potential. Here are some pointers that can help you do so:

**Tenure of the key management:** How long has the key management been with the company? Good companies have experienced people in the management team, who have been associated with the company for a long time.

**Integrity of the management:** What is the general image of the management? Is it considered clean and competent? Or are there pending legal cases against it? Have the promoters ever been convicted?

**Decision-making ability:** How good have the decisions taken by the management been? Has it come under fire due to some strategic move? If yes, why and what did it do to solve the crisis?

**Treatment of minority shareholders:** What is the management’s attitude towards minority shareholders? Do its decisions negatively impact them? For instance, diluting equity by issuing fresh shares to fund frivolous expenditures shows a lack of concern for small shareholders.

**The holdings of big guys:** Mutual funds like to own shares in companies with competent managements. If a company has little or no fund holding, it’s likely that fund managers don’t have trust in the management’s abilities.

**Levels of pledged shares:** Pledging of shares is a practice by which promoters take a loan against their shares in a company. A high level of promoter pledging is alarming as it signals a deteriorating financial condition. In extreme cases, a promoter may even lose control of his company.

The various disclosures that listed companies have to make to the stock exchanges have information about key management decisions. Do make use of them. The Value Research website also has ample management-related information. Just go to any stock page and click on the ‘Directors Report’ tab.
In the stock market, identifying a good business is not enough; buying the stock at the right valuations is as much important. Valuing a business means assessing its worth so that you can know if the price you are going to pay for it is reasonable. Smart investors want to buy a business available at less than what it's worth. If you pay too much for the stock, no matter how good the business, it's likely that you will not make meaningful returns or, worse, lose money.

How do you assess valuations? While there are some tools available to assess valuations, there is no one definite formula that you can apply to all cases. In fact, valuation criteria may vary from industry to industry. For instance, while it’s okay for FMCG stocks to trade at comparatively high multiples, metals and mining stocks tend to trade at low multiples.

Assessing valuations is also a matter of analytical judgement. You can’t always tell whether you are paying the right price. For instance, a debt-laden company may be available at cheap valuation multiples and a company with good earnings visibility may tend to trade at high valuations. Hence, valuations can’t be seen in isolation; they should be viewed in conjunction with the quality of a business and its various intrinsic aspects.

Valuations also vary with the economic potential of a country. A country with high growth rates and political and economic stability will have higher valuations than a country which is struggling to hold itself together.

Overall, assessing valuations is like buying vegetables: you want to buy the good ones at a reasonable price; you don’t want to buy the bad ones cheap; and you avoid buying the good ones at exorbitant prices.

Valuing a business means assessing its worth so that you can know if the price you are going to pay for it is reasonable.

Here are three popular valuation measures:

**Price-to-earnings (P/E) ratio:** The P/E ratio is perhaps the most widely used valuation measure. It tells you what you are paying for every rupee of a company's earnings. If you buy a stock at a P/E of 10, it means that you are paying ₹10 for the company’s earnings of ₹1. Naturally, you will want to pay as less as possible. But here is a word of caution. As stated above, study the business before applying this valuation measure to it. A low P/E doesn’t always indicate a bargain and a high P/E doesn’t always signal expensiveness.

**Price-to-book (P/B) ratio:** The P/B ratio tells you how expensive a stock is in relation to its worth on the company’s books. A P/B ratio of over one means that the stock is quoting at a premium to its actual worth.

Both a high P/B and a low P/B should be explored. Don’t get too excited to find a stock trading below book. Such a stock could be a ‘value trap’, i.e., it’s cheap valuations are due to its bad fundamentals. On the other hand, sometimes the book value doesn’t capture the true worth of a company’s assets, which can make the P/B look artificially high. The P/B ratio is especially useful in the case of banks and non-banking finance companies.

**Price-to-earnings growth (PEG):** Popularised by the legendary investor Peter Lynch, it factors in the earnings-growth rate. It is obtained by dividing the P/E ratio by the earnings-growth rate. A PEG of less than one is considered attractive.
What is value investing?

There are many styles of investing: growth investing, momentum investing, dividend investing, tactical investing and so on. One form of investing that is followed worldwide by many sophisticated investors is value investing.

Popularised by the legendary investor Warren Buffett, value investing aims at buying stocks that are available at a discount to their intrinsic value. To put it in simpler terms, it’s about buying a `100 note by paying `80 for it.

But why would anyone sell a `100 note at `80? This happens because many investors don’t realise that it’s a `100 note. They think it’s a `50 note and are happy to sell it at `80. Hence, the task of a value investor is to unearth such companies which are currently disregarded by the market and other investors. Sooner or later, the market appreciates the error that it has been making and the price of a value stock surges. This means that being patient with value stocks is a part of the game. Also, it requires one to think differently from the herd.

**Spotting value stocks**
How do you spot value stocks? It requires quite some sophistication to practise value investing, yet the following points may help:
1. A value stock is generally overlooked. Nobody seems to care about the sector or the company. Many analysts start writing an obituary of the stock or the sector.
2. Look at the valuations. A value stock tends to trade at low valuation multiples in terms of price-to-earnings and price-to-book. Some value stocks may be going through some tough times because of which their profits would be low. This makes the P/E look artificially high.
3. Even though the P/E and P/B multiples fail to indicate value, on digging deeper, value stocks reveal significant potential or assets that are not captured in their valuations.
4. Spotting value stocks is not just about looking at the financials. It’s also about understanding the business, the management background and estimating how the business will do in the future. A short-term hiccup in business doesn’t dent the business prospects of a value stock.
5. Look for any competitive advantages and barriers to entry the business has. These provide a business an impenetrable zone of operation, which imparts such companies ‘value’. Also, high-quality businesses with a strong pedigree often offer value, even when their current valuations look stretched. Such businesses come with an in-built guarantee that they will be around and doing well for many years to come.

**Criticism of value investing**
The critics of value investing find the patience that it requires quite irksome. They say that when they can make money in the short term by following other strategies, why they should be concerned about value investing. The answer to this lies in understanding the spirit of investing. While money can be made in the short term by following some other methods, that also comes with a fair amount of risk; one may lose money as well. Investing is all about tilting the odds in your favour as much as you can. It’s not just about profits; it’s also about protecting your capital.

Does it mean that value investing is not risky? Any form of investing is risky. But you considerably reduce your risk when you buy something at a discount to its intrinsic value. You know that you haven’t overpaid and you will have the patience to stay invested – even increase your stake – if the market falls. This eventually results in handsome gains in the long term.
In investing, the concept of ‘moats’ was popularised by the legendary investor Warren Buffett. ‘Moat’ means a deep, wide ditch that surrounds a castle and is filled with water. In business sense, it stands for a company that has some sort of competitive advantage and barrier to entry into its area. In simpler terms, companies with moats are sort of monopolies and it’s very difficult to compete with them or usurp their market share.

The sustainability of a moat is even more important than the presence of a moat. While some companies may look like companies with moats in the short term, their competitive advantages can be eroded in the future. When this happens, the company and investors both suffer. How do you know whether a moat is sustainable? For that, you have to study what the company does. If its product or service is such that it will never go obsolete and it’s a strong brand that no competitor can challenge, the moat is likely to be sustainable.

### Features of companies with moats

Identifying companies with moats requires you to have a lot of experience in investing. Not just experience, it requires one to be patient and rigorous in one’s approach. Sometimes moats may not be easily visible. Many times they won’t be sustainable. Still, the following pointers can help:

**Strong brand:** A strong brand that cannot be replaced from its position in consumers’ minds is a moat. For example, Maggi is a strong brand of Nestle. After running into trouble in 2015, when it was declared unsafe for consumption, Maggi has been able to bounce back and regain its lost market. Such is the brand strength of Maggi that many of use the name ‘Maggi’ for the category of noodles itself.

**Great distribution:** Companies require many years to spread their distribution. Hence, companies with a widespread distribution are in a prime position. Pepsi’s Kurkure is a product that looks omnipresent. No matter where you are in India, you can easily find a pack of Kurkure at a nearby shop.

**High followership:** When numerous people congregate on a network, it increases the value of the network itself so much that others who aren’t a part of the network are compelled to join it. Think of Facebook or Twitter or LinkedIn or WhatsApp.

**High switching cost:** If it’s difficult to switch from something to another, the former can be said to have a moat. Take Microsoft Windows for instance. Windows is run on so many computers and so many of us have grown accustomed to it that switching to a different operating system isn’t easy.

**Low cost:** A low-cost producer can drive its competitors out of business. It can sell its product at wafer-thin margins, which its competitors can’t emulate. The low-cost advantage is especially relevant when the product itself is not the differentiator. For instance, take the steel business. Steel is a commodity. A low-cost producer has an edge in the business.

**Patents and trademarks:** Businesses that have valuable patents are insulated from disruption. This feature is especially found in good pharma companies.
If you thought that investing is all about analysis, you will be surprised to know that your own psychology is as much, if not more, important when it comes to investing.

You may still wonder what psychology has to do with the stock market. Psychology is the study of mind and behaviour. It is especially important in the stock market because market moves tend to be erratic and often irrational. If you don’t understand the psychology behind what causes them, you may be dragged along with them. This may hamper your chances of making money in the market.

A popular way of studying stock-market psychology is by studying the many thinking biases that investors suffer from. A bias is a faulty way of thinking that we have grown accustomed to. Take this instinct called loss aversion for instance. Investors react to losses more intensely than they react to gains. So the joy of making a gain of ₹10,000 is not as intense as the pain of losing ₹2,000. This is what makes investors sell in panic if the stock market goes down. As more and more investors join the frenzy, a crash happens.

Consider the 

**confirmation and availability biases** now. While researching a company, investors tend to focus on data and information which are easily available to them. This results in the availability bias. In place of looking for data which are not easily available, investors base their investment thesis on the available data. What’s more, having developed a viewpoint, they ardently focus on the information that confirms their viewpoint, rejecting any conflicting information and viewpoints. These two biases result in incomplete research, which may come to haunt back later.

**Herd behaviour** is often seen in the stock market. This causes particular sectors or stocks to become over-priced. A recent market fad was IPOs. In the bull run that started in 2014, many IPOs gave good listing gains. This attracted many more investors to the stock market, who called themselves ‘IPO investors’. Seeing this euphoria, more and more companies started making a beeline to list. Herd behaviour often leads to ‘market stampedes’, which leave investors bruised and wounded.

The iconic investor and Warren Buffett’s partner Charlie Munger has talked about the so-called liking/loving tendency. In investing, it means that investors frequently fall in love with their stocks. Because they have researched them, held onto them for a long time and perhaps are making paper profits on them, they stop being objective about them. They tend to ignore any adverse business development. This eventually results in wealth destruction. But even after wealth destruction has happened, the loving tendency causes investors to stay invested in hope of a recovery.

These biases are just a few among the many more that exist. A number of books are available on this subject. Here are a couple of them: *Misbehaving* by Richard Thaler *Thinking, Fast and Slow* by Daniel Kahneman, *The Art of Thinking Clearly* by Rolf Dobelli. A classic on this subject is *Extraordinary Popular Delusions and the Madness of Crowds* by Charles Mackay. A relatively new book is *Dollars and Sense* by Dan Ariely and Jeff Kreisler.

These books will not only throw light on investor psychology but also make you more rational about money, while also improving your thinking skills.
Stock gurus

An effective way to learn a skill is to go to someone who has mastered it. Stock investing is no different. There are many stock-market gurus that can help you understand not just how you should invest but also what you should do in times of crisis. For instance, Warren Buffett said, “Only buy something that you’d be perfectly happy to hold if the market shut down for 10 years.” This quote inspires us to take a long-term view on stocks and hence not get flustered in the event of a correction.

While the stock market has had many wizards, here are a few stock-market gurus and their brief profiles:

**Warren Buffett**
Popularly known as the Oracle of Omaha, Buffett is perhaps the most-admired stock investor in the world. He is a value investor and likes to invest in companies that have moats. He is also known for his long-term investment horizon. Though Buffett has himself never written a book, his wisdom has been captured in many books by different authors. He holds stakes in companies through his holding firm Berkshire Hathaway. Berkshire’s annual letters are a window into his mind.

**BOOK TO READ:** *The Tao of Warren Buffett: Warren Buffett’s Words of Wisdom* by Mary Buffett and David Clark

**Benjamin Graham**
Graham was Buffett’s teacher and a value investor. He is also known as the father of value investing. He popularised the concept of margin of safety. He believed in buying companies that were available at a discount to their intrinsic value.

**BOOK TO READ:** *The Intelligent Investor* by Benjamin Graham

**Charlie Munger**
Munger is Buffett’s partner at Berkshire Hathaway. He is also the chairman of Daily Journal Corporation. Munger is famous not just for value investing but also for his ‘Mungerisms’, which are witty words of wisdom.

**BOOK TO READ:** *Poor Charlie’s Almanack: The Wit and Wisdom of Charles T. Munger* by Charlie Munger and Peter D. Kaufman

**Peter Lynch**
Lynch was a star fund manager at Fidelity Investments. He said that in the stock market, professionals have little edge over ordinary people. Anyone who has time to do stock research can generate good returns. Lynch liked to visit companies before investing in them. He invested in a variety of companies such as fast growers, asset plays and turnarounds.

“The successful investor is usually an individual who is inherently interested in business problems.”

- PHILIP FISHER

**Philip Fisher**
Fisher was also a strong proponent of long-term investing. He founded an investment firm, Fisher & Co. He said that the best time to sell a stock is almost never. His most famous stock was Motorola, which he bought in 1955 and held onto it until his death in 2004.

**BOOK TO READ:** *Common Stocks and Uncommon Profits* by Philip Fisher
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1. Brings Discipline to Investing
   Investing on pre-set date every month makes you set aside a fixed sum of money to invest and gradually turns you into a disciplined investor.

2. Rupee Cost Averaging
   You get the more units when the market goes down and less when it goes up. Thus you average out the cost of buying mutual fund units.

3. Power of Compounding
   The longer you stay invested, greater is the benefit of compounding. It is like earning interest on interest. Hence start an SIP early and enjoy the power of compounding.

4. Convenience
   SIP offers convenience since you invest a fixed amount in every period without affecting your household budget. Remember: Income - Savings = Expenses & not the other way round!

5. Market Time
   Investing through SIP helps you avoid timing the market.

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**PRODUCT LABEL**

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<th>Name of the Scheme</th>
<th>This product is suitable for investors who are seeking*</th>
<th>Riskometer</th>
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