'Build a well thought out investment programme'

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There will always be short term volatilities in the equity market, and investors must get used to it, E.A. Sundaram tells ***Narendra Nathan****.*

The Indian economy is maturing and its growth rates are also moderating. Should investors lower their returns expectations from diversified equity portfolios in the coming years?

Historically, the long-term returns from the stock market have been in the range 16-17%, and the earnings growth has also been similar. This is not a coincidence. It has been established that there is a definite long-term co-relation between earnings growth rate and returns. If we go by the assumption that our GDP will grow 7-7.5% over the next decade, corporate earnings can be around twice that. With an expected corporate earnings growth rate of 14-15%, it is reasonable to expect a return of around that much in the long term; however, there will always be fluctuations in the meanwhile. There will be short term volatilities in the stock market, and investors need to be able to live with them. The only real risk is the permanent loss of capital.

How can investors avoid permanent loss of capital?

In order to avoid loss of capital, the investor must identify the probable causes for such a loss and avoid them. In equity investing, permanent loss of capital occurs mostly in three cases. First, when one invests in a business where the fundamentals are weak or are deteriorating. Second, when investment is made in a business that is run by an incompetent or dishonest management. Third, when one pays a very high price to buy a share. By avoiding these three mistakes as far as possible, the investor can reduce the chances of permanent loss of capital.

Further, when investing in equity, it is very important to ensure that the interests of main promoter and that of minority shareholders are aligned.

How do you see the broader market in terms of valuation right now?

We don't think the broader market valuations are cheap at present, but there are still good companies available at reasonable prices. We steer clear of the companies that quote exorbitant valuations.

Valuation ratios are relative and need to be compared with the expected earnings growth rate, as well as historical valuations, that is, the average over the past decade average, and the valuation of the peer set. Investors need to be careful about companies which have very low expected growth, or a significantly higher valuation than their historical average or peer group valuations.

> **"The only real risk involved in equity investing is the permanent loss of capital."**

When do you think the growth in corporate earnings will pick up?

The 'reversal to the mean' is a common phenomenon in the stock market, and since the earnings growth has been below the mean for the past two to three years, there is a high chance that it may move above the mean value over the next few years.

What will be the triggers for a pick up in corporate earnings?

There can be several triggers for this, both short-term and long-term. The most important short-term factors are higher government spending on infrastructure, good monsoon and the increased disbursement triggered by 7th Pay Commission. The long-term factors in this regard are the implementation of GST and the overall increase in agricultural productivity.

What are the themes equity investors can play now?

Investors can play the themes discussed earlier. For instance, the government is investing heavily in roads, power transmission, railways, coal mines, etc., and therefore, there is focus on the companies receiving orders due to this governmental push. Similarly, good monsoon and the implementation of 7th Pay Commission will increase consumption demand, helping stocks from the consumer discretionary and non-discretionary sectors. However, investors need to watch the valuations at which they are buying these counters.

There will also be a significant shift from the unorganised sector to the organised sector due to the implementation of the GST, which will boost the market share of several listed companies in the long-term. The implementation of the GST will also help logistics and other related sectors. Increase in agriculture productivity is another long-term trigger, which will help sectors like fertilisers, pesticides, farm mechanisation, etc.

Do you have any final suggestion for those looking to invest at present?

We have discussed the external part of investing, which demands excercising the intellect, but investors also need to manage the temperament or internal part of investing.

The best way to control greed and fear is to build a well thought out investment programme and then sticking to it, through thick and thin. It's wise not to bother too much about whether or not it is the 'best' investment programme. As long as it is a 'good' investment programme that works for them, the investor should stay with it.

Before embarking on an investment programme, investors need to be clear about certain things, like what they are investing for, what goal they seek to achieve with the programme of their choice, what extent of volatility they can withstand, whether or not they really understand the product they are investing in, etc. These are all internal factors, that are well within the investor's control, and when addressed properly, they can make it possible for any investor to implement a successful investment programme.

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