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Edelweiss ASSET MANAGEMENT

INSIGHTS

3 pieces of advice from John Bogle

If you are venturing into equity for the first time, these pointers from an iconic investor will help keep you on track.

One of the brightest icons in the financial world, John Bogle revolutionized investing. He championed the unembellished truth that every dollar an investor pays in expenses to a mutual fund, is a dollar he cannot use for his own savings goals. He founded Vanguard in 1975 and promoted index funds to the retail investor.

For new equity investors, here are three basic lessons you can learn from him before you venture into stock territory.

Invest you must but forget the "market".

Investing in equities is a winner's game. Not investing is the only way to guarantee that in the end you will have nothing.

Having said that, to speak of the 'stock market' on its own is meaningless. It's merely the value investors put on all those securities, thousands of different stocks with a value of trillions of dollars. It goes up and it goes down, but in the long run it goes up. Stock market fluctuations are just noise. A giant distraction from the business of investing.

The prices of common stocks are evanescent and illusory. That is because equity shares themselves are merely derivatives of the returns created by publicly held corporations and the vast and productive investments in physical capital and human capital that they represent.

Thanks to the growth, productivity, resourcefulness, and innovation of these corporations, capitalism creates wealth, a positive-sum game for its owners. The returns earned by businesses are ultimately translated into the returns earned by the stock market.

Will there be bumps along the way? Of course, and some quite large. Think of the Great Depression and the Global Financial Crisis. Periodic bumps nevertheless, the trend is a gradual upward slope.

Conversely, at times, stock market returns get well ahead of business fundamentals. But eventually, as if drawn by a magnet, they soon return.

When the returns on stocks depart materially from the long-term norm, it is rarely because of the economics of investing-the earnings growth and dividend yields of the companies. Rather, the reason that annual stock returns are so volatile is largely because of the emotions of investing, reflected in those changing P/E ratios.

In the end, sanity will prevail.

So don't ever forget the law of Reversion to the Mean.

In finance, the theory of mean reversion suggests that a stock's price will tend to move to the average price over time. The idea is that an asset class has an average, or fair value. And whether the current value goes much higher or drops dramatically from that level, the market will eventually move it back. It's a matter of when, not if.

Practically, this means, what's hot today isn't likely to be hot tomorrow. Or the day after. Because despite a heady run-up, the stock market reverts to fundamental returns over the long run. (Or a stock that has been beaten down mercilessly will not stay that way forever, assuming fundamentals are intact.)

Over the short run, fundamentals are often overwhelmed by the current sentiment and speculation. The mistake people make is thinking that they can pick tomorrow's top funds or stocks by looking back to yesterday's winners. That is a grievous error. Instead, stick to fundamentals and do not follow the herd.

Time is your friend, Impulse is your enemy

Once you stick to fundamentals, let it work for you.

Intelligent investors must pay attention to the elements of long-term investing that are within their power to control. No matter how difficult or how much easier said than done, they must focus not on the market's sho rt-term direction, nor on finding the next hot fund or stock, but on intelligent selection.

Interestingly, the key to fund selection is to focus not on future return – which the investor cannot control – but on risk, cost, and time – all of which the investor can control.

Investment success takes time so give it time. Start early, even if the amount is miniscule, and never stop. Even modest investments in tough times will help you sustain the pace and will become a habit.

Give yourself all the time you can. Nourished by the miracle of compound interest, your portfolio should flourish with the market's passing cycles. For instance, over a 10-year period, if the returns are a nominal 10% p.a., an investment of Rs 10,000 will grow to almost Rs 26,000, more than 2.5x the initial investment. In 50 years, assuming the same return, it would grow to almost Rs 1.2 million, or 120x the initial investment.

Follow a simple plan and let the market cycles take their course. The relentless pursuit of unrealistic performance will distract you from one of the most important secrets of investment success: simplicity. Have a sensible asset allocation, a selection of quality funds, and balance risk and return.

Impulse is your biggest enemy. Have rational expectations about future returns and avoid chasing those as the seasons change. Dark winters will give way to bright springs. Don't let emotions get the better of you.

Just stay the course.

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.