

Learn with DNA...

## Analysts as entertainers

"I still wasn't convinced, until Bob whispered in my ear what I would make in the first year. It was about three times what I was paid at Bell Labs. I stopped protesting so loudly. He then said "And that's for being right just 51% of the time." Andy Kessler recounts in his book, *Wall Street Meat - My Narrow Escape from the Stock Market Grinder*. Kessler was a rank outsider on Wall Street, having come in as a semi-conductor analyst.

Now, what exactly is the role a stock analyst fulfils? At a very basic level, an analyst is supposed to have an opinion on the stock that helps investors make a decision whether to invest in that particular stock. But it is not as simple as that.

"Companies report earnings once a quarter. But stocks trade about 250 days a year. Something has to make them move up or down the other 246 days. Analysts fill that role. They recommend stocks, change recommendations, change earnings estimates, pound the table - whatever it takes for a sales force to go out with a story so someone will trade with the firm and generate commissions," writes Kessler.

And what does it take to become an analyst on the Wall Street? "Let's start with the basics. First, there are absolutely no qualifications whatsoever for an analyst job. I've always thought that a monkey could do the job, and many do. There are very few analyst training programs, and no obvious way to get a job as an analyst. Most are in the job by accident, as I certainly can attest to," he writes.

Over time, Kessler was able to form an opinion on analysts in the business. "By watching other analysts in action, I figured out there were three types of analysts. There are: 1) those who know somebody in their industry; 2) those who know their industry and 3) those who don't know anybody or anything. Lots of analysts had industry contacts - perhaps CEOs who they were buddies with or someone in the CFO's office who was feeding them information."

So, how do analysts who really do not know their industry survive? As Kessler writes "Though I was starting to be right on my stocks, I was increasingly convinced it didn't matter. I looked around the research department, and noticed that very few analysts were right about anything. The job of an analyst has more to do with impressing everyone they come in contact with, and less to do with stocks. At one meeting I had with Fred Kittler, a portfolio manager at JP Morgan, he paused, looked me in the eye and said, "You realise, you are not in the analysis business, you are in the entertainment business."

# Getting the most out of MF investments

Here are some important considerations while building your portfolio

V S Arun Kumar



Mutual funds have been able to tap and unearth tremendous potential among retail investors. Since January 2003, the total asset under management (AUM) of the mutual fund industry has grown at about 36% a year. While awareness has been increasing, retail participation is still on the lower side. The future thus looks very bright for the mutual fund industry.

Mutual funds appeal to investors who may not want to directly invest in the shares of a company and would also have a cushion through diversification. They deploy the resources by investing in the equity market, debt market and the money market.

With increasing AUM, the mutual fund industry also has to deploy the resources into profitable opportunities. Yet, while the fundamentals of the Indian economy look strong, several factors could affect the performance of the financial markets in the near term: US recessionary fears, crude oil prices, liquidity, etc. Does this mean a retail investor should stay out of the markets?

Let us first analyse the need to invest in the market. Inflation is always considered the enemy of any investment as it reduces the purchasing power of the rupee earned. To have a better inflation-adjusted return, investment in a capital appreciating asset class is essential. Equity is considered the best among them.

Secondly, to create wealth over a long-term horizon, equity investments must be a part of your portfolio. It is an established fact that an investment in equity has to be for the longer term, and sensibly so, for the Sensex has returned a CAGR of about 19% since its inception in 1978-79. Also, the longer your in-



vest for, the less you can lose (see chart: Probability of loss).

Keep in mind the following while investing in mutual funds.

### I. Importance of asset allocation

Studies have shown that your returns depend on the way in which your assets are allocated in equity, debt and cash, and how they are rebalanced, more than on the timing or the specific securities you invest in. Most investors focus on individual security selection and often overlook the importance of asset allocation in their portfolios. A study by Brimson, Hood and Beebower shows that about 93% of the return expectations are determined by how your assets are allocated. So, before making any investment decision, understand your risk appetite and accordingly work out the asset allocation.

### II. Diversify across fund houses, sectors and market caps

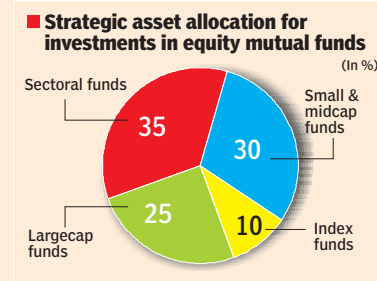
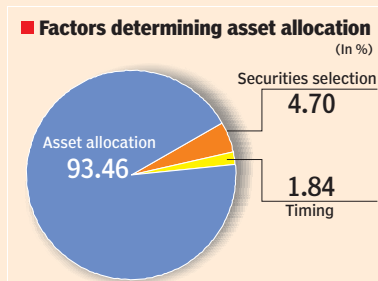
Mutual fund investment in itself offers diversification, but investing across good fund houses can provide better safety and returns. Each fund house has its own style of investing; some may offer

expertise in research, some in picking value stocks and some in growth stocks. Invest in a fund house, which has witnessed all the market cycles and fluctuations, and which has withstood the test of time.

Diversification across sectors and market capitalisations provides a hedge against any downswing. Not all sectors would be contributing to the economy at a given point in time. But, these sectors may well provide a hedge against possible downswings in other sectors. Similarly, sectoral and small- and mid-cap funds may outperform the large-caps and index funds in the long run, but they are also exposed to a lot of risk. This would be hedged against by investing in index and large-cap funds. But, of course, the asset allocation mentioned below would be based on your risk appetite. The younger you are, the more aggressive you should be. That's how the power of compounding would work.

### III. Select different SIP dates for investments

While investing systematically in



### Winning fiver

**Allocate assets** to equity, debt or cash depending on risk appetite and age  
**Diversify among** sectors, fund houses and market caps  
**Choose different** investment dates for every SIP  
**Avoid investing** in NFOs unless it offers something really different  
**Do your own research** before investing and review investments periodically

an NAV of just Rs10 instead of a fund that has a prevailing NAV of say Rs150 easily lures the investors. Avoid investments in NFOs unless it has something new to offer.

### V. Research

Spend time in researching the fund house, fund manager, their style of investing and assess the past performance of funds. Though past performance is no indicator for future performance, it does give clarity on how the fund has performed vis-à-vis the benchmark. All funds provide a monthly factsheet.

*The writer is a certified financial planner, working as senior manager with Mumbai-based SRE Financial Planners. Views are personal and do not necessarily represent those of FPSB India. Feedback may be mailed to myplan@fpsb.org.*

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## 'A 20% upside from here, at best'

Structured products and investment classes such as private equity and real estate should take centre stage

Sanat Vallikappen, Mumbai

**C Jayaram**, executive director of Kotak Mahindra Bank is a realist when it comes to expectations from the market.

"We would be lucky to get a peak this year that's 20% higher than current levels," said Jayaram, when *DNA Money* met him on Thursday, a day on which the Sensex closed at 17,648.71 points.

A 20% upside from that translates to approximately 21,180 on the Sensex. That's just 100-odd points from the index's all-time high (intra-day) of 21,077, which it scaled on January 8, 2007, before the wind-down began.

When a number of brokers have been propounding the decoupling theory, in which they say that the Indian markets are more resilient and will not be affected by the US-and exactly the opposite of that has been happening - Jayaram's take on the subject comes as a refreshing change.

"Given a choice, everyone likes to be bullish, and theory after theory comes up which may not be based on fundamentals," said Jayaram, an alumnus of the Indian Institute of Management, Kolkata.

However, he does feel the correlation has gone well below 1, and that



emerging markets including India would get a larger share of the world's fund flows; only that these fund flows have now become smaller, with asset allocation clearly not favouring equity.

There's one other theory that Jayaram thinks to be flawed: that when interest rate differentials widen between the US and India, that should result in more money coming into Indian equity. "The theory stating that money parked in US debt would flow into Indian equity, or that money that can be cheaply borrowed in the US would flow into Indian equity, seems

too aggressive," he says. According to him, it should flow into Indian debt (as long as government-imposed ceilings are removed), and not into equity, if any benefits are to be derived of the differential.

But while he rubbishes theories, he does not rubbush the effects of growth exemplified by countries such as India and China. "Our equity return should be far higher than what one might get in the US. That should see some money come from the US, which still commands one-third of all the world's financial assets," said Jayaram.

That macro indicators are in

place, corporate growth rates are close to 20%, and the consensus view being that the rupee will strengthen against the dollar, makes India still an option as far as the international investors are concerned.

For domestic investors, Jayaram, who is also head of the wealth management division of Kotak, feels that structured products and alternative investment classes such as private equity and real estate, should take centre stage, now that investors have understood that the stock market's not just a one-way street up.

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## Nifty hourly resistances for February 4, 2007

Time AM/PM	Resistances Upon surpassing (1)	resistances exhausts (2)	Rally at (3)
09.55 - 10.30	5203	5155	5109
10.30 - 11.30	5209	5160	5112
11.30 - 12.30	5215	5165	5115
12.30 - 13.30	5221	5170	5118
13.30 - 14.30	5227	5175	5121
14.30 - 15.30	5233	5180	5124

**NOTES**  
Trading derivatives is a risky activity. These studies do not assure profits. Please consult a certified financial analyst before trading.

-Vijay Bhambhani

## Post office deposit rates and features

<b>■ Kisan Vikas Patra</b>	
Interest	Doubles in 8 yrs 7 mth
Effective interest rate	8.41%
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	None
<b>■ Monthly Income Scheme</b>	
Interest	8%+ 5% bonus at maturity
Tenure	6 yrs
Min. amount	Rs 1,000
Max. amount	Rs 4.5 lakh for single a/c Rs 9 lakh for joint a/c
Tax breaks	Section 80C deduction
<b>■ National Savings Certificate</b>	
Interest	8%
Effective Interest Rate	8.16% (semi annual compounding)
Tenure	6 yrs
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	Section 80C deduction
<b>■ Public Provident Fund</b>	
Interest	8%
Tenure	15 -16 yrs
Min. amount	Rs 500
Max. amount	Rs 70,000 p.a.
Tax breaks	Section 80C deduction
<b>■ Recurring Deposit</b>	
Interest	7.5%
Tenure	5 yrs
Min. amount	Rs 10
Max. amount	No limit
Tax breaks	None
<b>■ Senior Citizens Savings Scheme</b>	
Interest	9%
Tenure	5 yrs
Min. amount	Rs 1,000
Max. amount	Rs 15 lakh
Tax breaks	Section 80C deduction
Min. age	60 years
<b>■ Time Deposit</b>	
Interest	6.25-7.5%
Tenure	1,2,3,5 yrs
Min. amount	Rs 200
Max. amount	No limit
Tax breaks	None

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Good traders are made, not born, writes Michael W Covel

## It pays to be a turtle in the stock market, sometimes

Vivek Kaul, Mumbai

How would you feel if someone gave you a million dollars to trade, and taught you all the rules of trading before that? I can already see people turning around to ask, "Is that some sort of a joke?"

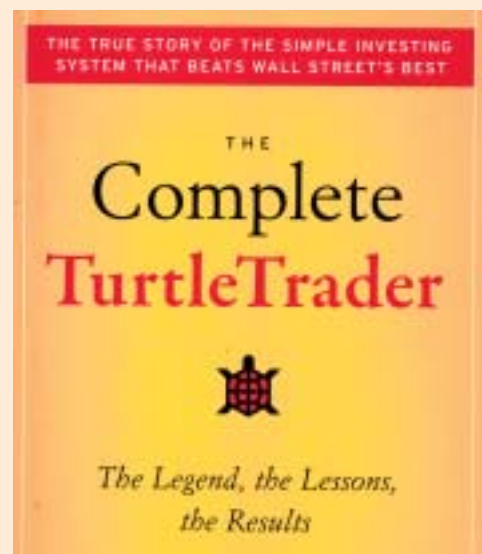
But, that's precisely what happened in Chicago, sometime in the early '80s. Richard Dennis, the reigning trader king of Chicago wanted to settle a decade-long debate with his partner William Eckhardt - was it nature or nurture that mattered when it came to being a successful trader: Were good trading skills inborn or could they be taught?

As Michael W Covel writes in the *The Complete Turtle Trader, The Legend, the Lessons, the Results*, "One of these arguments was whether the skills of a successful trader could be reduced to a set of rules... Or whether there was something ineffable, mystical, subjective, or intuitive that made someone a good trader."

Dennis and Eckhardt decided to settle their debate once for all. An advertisement was put out, inviting applications. "Mr Dennis and his associates will train a small group of applicants in his proprietary trading concepts. Successful candidates will then trade solely for Mr. Dennis. Prior experience in trading will be considered, but is not necessary," ran the advertisement. Interviews were held and people were hired. And the entire group was known as Turtles.

But why the name Turtles? "It was simply the nickname Dennis used for his students. He had been on a trip to Singapore and visited a turtle-breeding farm. A huge vat of squirming turtles inspired him to say, "We are going to grow traders just like they grow turtles in Singapore," writes Covel. The Turtles were then trained for two weeks. After training, each was given a million dollars to start trading on the basis of what he/she had learnt. Covel writes, "Dennis and Eckhardt taught their students everything they needed in only two weeks to trade bonds, currencies, corn, oil, stocks, and all other markets... Each student received \$1 million to trade after his classroom instruction."

"The Turtles were trained to be trend-following traders. In a nutshell, that meant that they needed a "trend" to make money. Trend followers always wait for a market to move; then they follow it. Capturing the majority of a trend, up or down, for profit is the goal," writes Covel. In other words, the Turtles had been trained to buy when the market was on its way up or as it became more expensive and short-sell when the market was falling. This clearly went against the conventional Wall Street wisdom of buying low and selling high. "What Dennis and Eckhardt were teaching was the exact opposite of Warren Buffett's buying "value." "But that is easier said than done. How do you know whether a market is on its way up or down? Here is where the trading rules that Dennis and Eckhardt had developed over the years came in.



The Turtles had to wait for breakouts to happen. "If a market made a new four-week high, the Turtles would buy. They would exit if/when it made a two-week low," writes Covel. This, along with a few other rules and filters, became the Holy Grail for the Turtles. It was important for them to have emotions under control and follow the rules. "You are not special. You are not smarter than the mar-

"You are not special. You are not smarter than the market. So, follow the rules. Whoever you are and however much brains you have, it doesn't make a hill of beans' difference."

ket. So, follow the rules. Whoever you are and however much brains you have, it doesn't make a hill of beans' difference." The other important thing was that the Turtles just traded numbers. As Tom Willis, Richard Dennis's protégé says in the book, "They don't know anything about bonds. They don't know anything about currencies... They are just numbers. Corn is a little different than bonds, but not different enough that I'd have to trade them differently. Some of these guys I read about have a different system for each [market]. That's absurd. We're trading mob psychology. We're not trading corns, soybeans, or S&P's. We're trading numbers."

This experiment went on till 1988, when Dennis pulled the plug on it. Most of the Turtles, while they traded for Dennis, did very well for him and themselves. Out on their own, though, the world was a totally different place. Some of them could not keep up with their initial performance and faded into mediocrity. But, others have kept the flag flying and made good money for their clients and themselves over the years.

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