

To Buy, Hold, Sell Check With Your Financial Plan

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IT IS true that all investors have experienced volatility in their portfolios in the last few days. There are three decisions which an investor has to take amidst this volatility: buy more, hold or sell. If an investor understood equity when he bought then he would either buy more or at least hold on, rather than sell. If he sells at this point in time, then his first decision of buying this asset class was not correct.

As a financial planner I would recommend investors to work on the principle of asset allocation where the investor decides a strategic asset allocation on the basis of his needs. Strategic asset allocation is the division of the portfolio based on long-term expectations for returns, risk and correlation between various asset classes. Doing this exercise

gives the direction to the investor on how much he should be exposed to various asset cases like debt, equity, real estate, money market and so on. This approach gives clarity to investors on what to do with their portfolio at times like this. Today the investor can follow three strategies: conservative, active or aggressive.

● **Conservative Strategy, Hold On:** Hold on to the investments and not do anything. If the markets have fallen by about 20 per cent, a rise back of 25 per cent would bring back the same asset allocation.

● **Active Strategy, Rebalance:** This aims to reduce the per unit risk of the portfolio in the long run. Let's say an investor has a strategic asset allocation of 70 per cent debt and 30 per cent equity which would have been maintained on April 30th, 2004. Equity markets going down by about 20 per cent would shift the allocation in favour of debt and reduce the equity exposure to about 25-26 per cent. At this point, one should come back to the

original or strategic asset allocation and buy more equity (4-5 per cent) with the fresh surpluses or shift a part of the debt portfolio into equity. While shifting, one needs to see what is the cost involved (penalty or taxation) in doing this exercise. This strategy gets you to buy more when markets have fallen and when it is available

at lower prices.

● **Aggressive Strategy, Reallocate:** This aims to improve the return per unit of risk of the portfolio in the long run. If the above investor decides not only comes back to

the original asset allocation (after the market drop) but also imposes the tactical asset allocation on top of his strategic asset allocation. This means that if the markets have fallen by 20 per cent and assuming this has happened with the same earnings growth for the corporate sector, it indicates that equity markets are underval-

ued by about 20 per cent. The investor can now increase the exposure to equity from 30 per cent to 36 per cent which would mean buying more equity with the fresh surpluses or shift a part of the debt portfolio into equity. Doing this one is simply buying higher quantity of equity when the markets have fallen and when it is available at lower valuations.

The above strategies would depend on the profile of the investor. A conservative or balanced profile of an investor should look at the active strategy while an aggressive investor could look at the reallocation strategy.

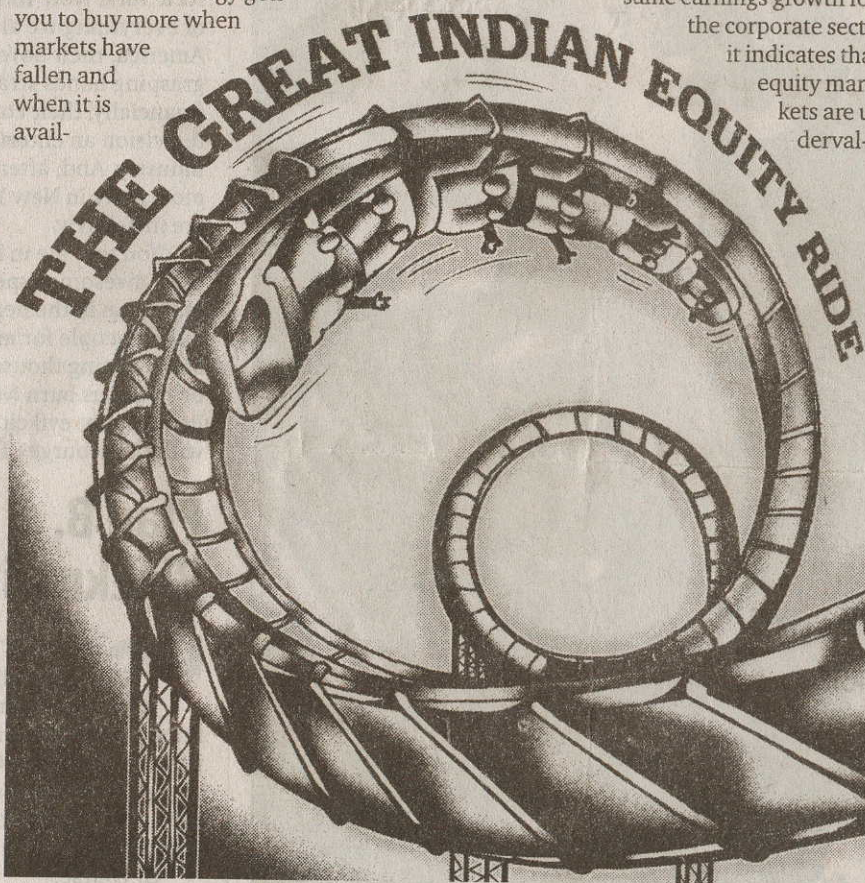


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