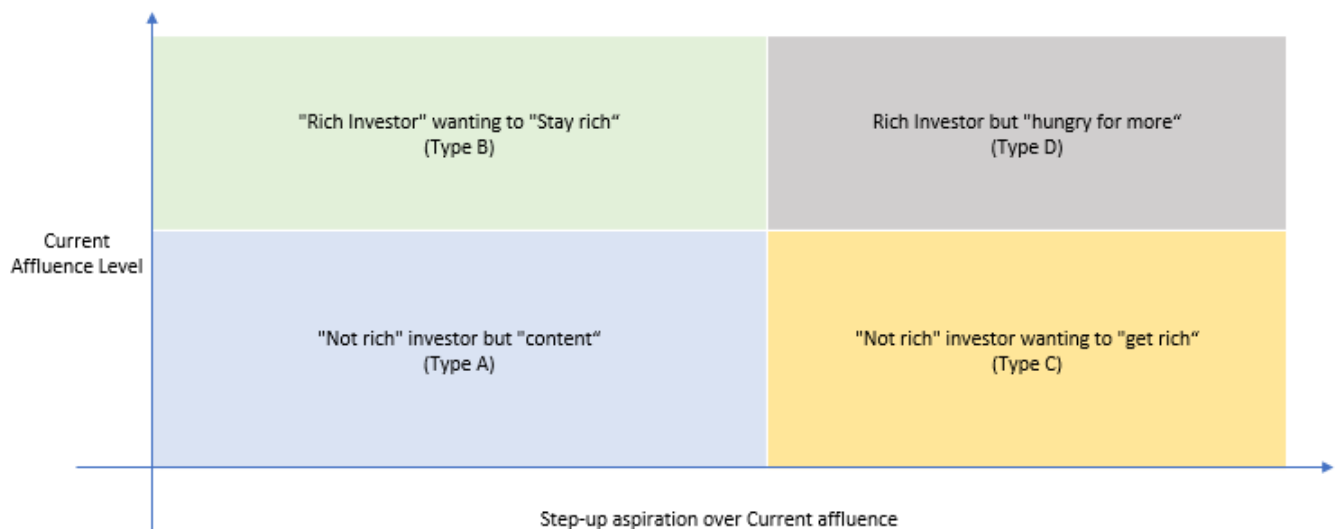


When you look at the investing community, there are basically two kinds of investors – those who want to “get rich” and those who want to “stay rich”. While the “stay rich” investors, by definition, would already be “rich”, the “get rich” investors could include not only those that are “not rich” currently but also those that are “rich” currently but are hungry for more.

It is very important for an investor to clearly identify the category that he fits into. Also, it is important that the investor understands that this “category” cannot be a moving goal post. Most investors, in a down cycle, prefer “safety” and in an up-cycle, prefer “high returns”.

What is important is that an “investor” needs to identify his category, make peace with it, and stick to it in “good times” and “bad”. Shifting categories frequently only leads to behavioural errors and this, we think, is the main reason why investors generally have a bad experience in the stock markets.



When an “investor” decides the “category” he belongs to, he should also pay attention to his current level of affluence. The basic question is “do you want to risk what you have for what you don’t have?”.

Logically, a person who is already rich “might” not want to risk what he has for what he does not have. Similarly, a person who wants to get rich “might” want (or need) to risk what he

has for what he does not have.

However, in the real world, risk-taking depends a lot on behaviour and “DNA” than on pure logic. So, you need to be honest with yourself when classifying yourself into these investor categories.

Let’s take a look at the Risk profiles for each of the four investor types:-

Type A – These are generally retail investors who are very conservative and consider the “stock market” as a risky place to be in.

- They are very prone to “behavioural errors” if they were to experience a “drawdown”.
- Their level of sophistication is also generally low and can get trapped into misselling by Asset Managers with “guaranteed” monthly returns and so on.

Type B – These are HNIs and UHNIs who have a high level of financial literacy.

- They are generally not in any race to get the “best returns” but are content as long as their purchasing power is increased year over year (above-inflation returns).
- However, since they are rich and have the ability to pay fees, they also suffer from the risk of “excessive intermediation” and are often distributed “excessively complex” products with high expense ratios.
- They prefer sleeping well at night over an additional 200 bps return through a risky investment.

Type C – These are generally retail investors who have a strong drive to get very high-returns. They tend to chase returns and are willing to go down the quality curve (or very risky asset allocation) as long as it promises a high return. This strategy requires an ability and willingness to stay unperturbed through periods of massive drawdowns but can also lead to a very strong performance in bull markets.

- The drive of these investors also makes them prone to take leverage to maximise returns. This, we think, is an emotionally stressful strategy. Only a few can have the behavioural make-up to practice it successfully.
- Unlike Type A, which might fall prey to products that erroneously promise a guaranteed return, these investors can fall prey to “chasing” those asset classes that have given a very high “recent return”. This behaviour stems from their desire for a higher return portfolio and a misplaced belief that returns from the last three years will be an indication of returns in the

next three years.

Type D – These are HNIs and UHNIs who, despite being rich, are driven to achieve very high returns.

- These returns might not be required to sustain their lifestyle, but they love playing a game that they must win.
- Like Type C investors, this strategy requires an ability and willingness to stay unperturbed through periods of massive drawdowns, but can also lead to a very strong performance in bull markets.

While it is easy to classify yourself into one of these four categories on Day 1, what generally happens is that you tend to digress towards another style in periods where your own style is underperforming, when compared to others.

For example, during a bull market, a Type A investor feels that he is underperforming as against a Type C investor and that he ought to take higher risks. And at the peak of the market, he tends to make the switch at precisely the worst of times. Similarly, a Type C investor, during a bear market, feels that all this risk-taking is not worth it and he needs to get into safety, again making the switch at the worst of times.

When investors compare investment alternatives, it is also very important for them to understand the risks that were taken to generate the returns that were generated.

For example, compare a portfolio that generated 16% returns by 50:50 mix between “fixed income: equity” with a portfolio that generated 18% returns by 10:90 mix between “fixed income: equity”. Your choice of the portfolio depends entirely on the type of investor you are.

Type A and B would prefer the former portfolio, and Type C and D would prefer the latter portfolio. However, since some of the nuances of performance are not well-understood, money flows to the latter portfolio from even those investors for whom the incremental 200 bps returns are not worth the additional risk that stems from a higher equity allocation.

Every style goes through a period where it looks either out-of-favour or out-dated. And history also suggests that every style gets back in vogue. What is important for investors is to be true to their objectives, have realistic expectations, and not let envy get the better of

themselves.

Conclusion

To summarize, here are some key takeaways for investors –

When comparing investment alternatives, investors should not judge A versus B purely based on past returns.

The nuanced measure of risk like “volatility”, “fall from peak” in bad times, “average equity weights” to get these returns, etc. should also be looked at. If dealing through an intermediary, investors should insist on these numbers to make holistic decisions.

Investors should classify themselves into one of the four categories mentioned above and stick to it in good times and bad. Switching from one category to another based on the flavour of the market is likely to hurt more than help.

If dealing with an “advisor” or “intermediary”, the “investor” should make sure that the “advisor” or “intermediary” understands the investor’s risk profile and objectives and recommends “products/ schemes” suitable for such a profile.

Lastly, it is also important for Asset Managers (like PMSs) to have a well-defined “investment strategy” and a clear “target market” that they intend to cater to, through this strategy. A conservative “investment strategy” might underperform in a roaring bull market and might even lead to the “Asset Manager” losing clients during such a period.

This should ideally not lead to the “Asset Manager” suddenly changing their strategy from “conservative” to “aggressive”, because every “Asset Manager” should have a core investment philosophy that cannot change based on what is “in” or “out” of favour.

At Multi-Act, we focus on providing reasonable returns with an endeavour to minimise drawdowns (drop from peaks). Our investment process tries to identify opportunities that could provide disproportionate gains for a given level of risk (downside). By consistently identifying such investments and our willingness to sit on cash when such opportunities are not available, we build portfolios that could provide superior risk-adjusted returns in the long run.

If you would like us to evaluate Mutual Funds or your Portfolios from the above Return vs. Risk perspective and if you wish to understand more about our investment process, please

get in touch with us.

Disclaimer

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Risk factors

General risk factors

Securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.

Past performance of MAECL does not indicate its future performance.

As with any investment in securities, the value of investments can go up or down depending on the factors and forces affecting the capital market. MAECL is not responsible / liable for any losses resulting from such factors.

Securities investments are subject to external risks such as war, natural calamities, and policy changes of local / international markets which affect stock markets.

MAECL has renewed its SEBI PMS registration effective October 14, 2011, and has commenced its portfolio management activities with effect from January 2011. However, MAECL has more than 10 years of experience in managing its own funds invested in the domestic market.