Common Mistakes

1. Investing in stocks from borrowed money is a dangerous practice unless you have enough expertise on the subject
2. Trading in “Futures and Options” is the worst ever decision for any retail investor. You can lose your entire life’s savings.

Why free trading tips are dangerous

Motive 1: Many operators provide free trading tips after offering the same to their paid clients. Thus, stock price gets manipulated which in turn helps only their paid clients

Motive 2: Operators often offer free tips just to have a smooth exit at hefty profit.

Why paid trading tips are sometimes more dangerous? - lose your invested amount but also your subscription amount. - 4 month trial (earn money) - subscription (loose money)

Be aware of high return promises. 50%+ monthly return promise is the almost sure-shot sign of fraud

Dangerous traps to be avoided : temptations from friends, broker, so called analysts, stock tips provider, overconfidence

Only way to earn consistently from stock market

1. The only way to accumulate wealth from the stock market is to invest in high-quality business (stock) and hold the same for the long run.
2. You can’t make money consistently via any form of short term trading. (Intraday, Futures & Options, margin trade, etc.)

Keeping money in a bank account is riskier - in conjunction with tax and inflation, fixed deposit can’t offer a positive return

Few investment options (like real estate and equities) can offer above inflation return.

Investment in knowledge pays the best interest, then Equity investment is the most convenient option for long-term wealth creation.

Real estate requires big-ticket investment , start with stock market only if you have enough to loose

A stock is nothing but a partial ownership in the business.

<u>First Step of Picking Winning Stocks</u> : should not put a priority on profit and sales numbers, put priority on Return on Equity (ROE)

<u>Return on Equity</u> : amount of net income returned as a percentage of shareholders equity,

= Net Income/Shareholders Equity

Economic Moat /Competitive Advantage : Differentiating factors for your products include features, technology, specification, durability, appearance or anything else.
analyze the supply demand scenario, customer base, and product/service differentiating factors
Return on Equity (ROE) offers an approximate view. Increasing ROE over the last 5- 10 years with improved operating margin and cash flow is a signal of sustaining economic moat
It is highly recommended to avoid high debt companies. Avoid stocks having debt to equity ratio more than 1 (increasing) and ROE less than 12% (decreasing over the last few years)

Easiest Methods for Management Evaluation : 3 outputs are required Shareholding Pattern, Dividend History and Tax Rate, Return on Equity (ROE)
Management Evaluation #1 - Shareholding Pattern Analysis

1. Promoters and Promoter Group- Promoters are those who incorporated the company. They can be either domestic or foreign entity (or group of individuals).
   Promoter increase their stake : 1. To utilize idle cash efficiently 2. To make the most from lower valuation 3. To acquire greater control of the company
   Promoters rarely increase their stake during bull market – Increasing promoter holdings either results in price appreciation or downside protection of the stock. If the promoters raise their stake, it is comprehended that they has high confidence in the business.
   Promoters decreasing their stake can have either positive or negative effect on the stock price.
2. Public Group- Shareholders other than promoters constitute Public shareholding pattern. FIIs, DIIs, banks, money managers, mutual funds, insurance companies, individuals, etc.

Institutional investors includes the pension funds, money managers, mutual funds, insurance companies, investment banks and commercial trusts. They buy large quantities of shares leaving a high impact on the stock market's movements
FII (Foreign Institutional Investors) : darlings of the company. They are the drivers of the stock market, The key to successful investing lies in identifying a stock that can become favourite among FIIs in the near future
Domestic Institutional Investors (DII) : Institutions or organisations such as banks, insurance companies, mutual fund houses, increased investment from DII is positive for any stock.
Individual Investor : Individuals are many in numbers, even lakhs and crores forming a part of the shareholding pattern. But stock prices don't get affected by individual retail investors transactions, have least amount of knowledge and are mostly carried with emotions

Pledging of Shares – Why it is Dangerous for Shareholders? : Pledging of shares is a process when the promoters keep the shares of the company that they own as collateral for the debt. They take loan either to satisfy their personal needs or for funding the company's business. Pledging of shares is done with banks or non-banking finance institutions offering loan to promoters. The loan provided is generally 25%-70% of the share value depending upon the liquidity in the market, type of business and of course the reputation of the promoter.

Why pledging of shares is extremely risky? : Pledging of shares is the last option for promoters to raise fund. It means that no one else is ready to provide loan because either the company is in bad business whose future prospect is not bright or the company has high debt and might be under financial constraints, hence pledging remains the only option left.

pledging can even lead to promoters losing their stake in the company

If pledging of shares is so risky then why do Promoters go for it? : Fund-raising is very difficult during adverse macroeconomic situation due to the economic slowdown and the increased cost of borrowing. However to expand the business one needs to raise funds. So, in this scenario pledging of shares has come up with the convenient solution. Another thing is that if any company is already laden with debt then they don't get further loan without collateral. In such scenario, the only option that left is pledging of shares

Pledging of Shares – What Investors Need to Do? : Always avoid companies where promoters are increasing their pledged shares. Investors should keep a close watch on the percentage of shares promoters have pledged. An increase in pledged shares may devastate the earnings of the company, thus leaving no room for earnings growth. High debt follows high pledging of shares. So, a major part of the profit goes to paying the lenders.

Avoid companies where promoters pledge more than 30%of the holdings and pledged percentage is increasing

Management Evaluation

1. "Dividend" is nothing but sharing partial profit with shareholders.
2. Higher dividend payout ratio with increasing dividend rate confirms shareholder's friendliness of management.
3. High and consistent ROE(Return on equity) is an indication that the management is utilising the capital effectively.

Management-Business combination	Stock Return
Great Management – Great Business	**Potential multibagger**
Great Management – Bad Business	**Cyclical return**
Bad Management – Great Business	**Moderate return**
Bad Management – Bad Business	**Wealth Destroyer**

Common Valuation tools

Price to Earnings ratio (P.E ratio)

1. compares the current market price of the stock with its earnings per share. So P.E ratio = Current market rate/ Earning per share (EPS). There are two ways to calculate P.E ratio; trailing and forward. Trailing P.E ratio considers the EPS of past four quarters while forward P.E considers the analyst's estimation of the next year's EPS. Maximum financial websites report trailing P.E ratio whereas various brokerage houses present forward P.E in their research report
2. Best Usage of Price to Earnings ratioYou can compare a stock's P.E with its last three years or five years historical P.E., You can compare a stock's P.E with other stocks those are in the similar business, You can also compare a stock's P.E with the P.E of Sensex to get a rough idea of the valuation.
3. What drives P.E ratio? - Some stocks (mostly from Pharma and FMCG sector) always trade at a higher P.E while stocks from infrastructure or realty sector often trade at much lower P.E, High growth companies always demand a higher PE. If a company is consistently growing faster than its peers across the market cycle then most likely it will continue the trend, Companies those generate massive cash flow are less leveraged. Moreover, these companies can easily meet their working capital requirements quite comfortably
4. Drawbacks of P.E ratio - (Accounting tricks) a company can easily distort their reported profit. There are several accounting tricks by which a company can inflate (or sometimes deflate) their earnings, If a company recently sold some of its assets or some other business then that income is recorded as "onetime gain/profit"One-time income can easily inflate earning/profit and thus lowers the P.E ratio. Similarly, the one-time expense can negatively affect the reported profit and thus translates into higher P.E. , Cyclical firms are those companies whose profit increases heavily during a particular period, then decreases after some time. Again increases and again decreases and the cycle continues. (Eg : Automobiles)So, if you find a low trailing P.E of any such cyclical companies, don't get tempted. It may happen that in the near future, earnings may fall, Low P.E may be the indication of bleak future

Price to Sales Ratio (P.S ratio)

1. current price of the stock divided by the sales per share, calculated by dividing market capitalization of a company by its reported total sales.
2. Advantages : total revenue (sales) is not frequently manipulated, Sales are less volatile than earnings.
3. Disadvantages: total sales can't ensure profitability, Net profit margin varies from company to company, check the industry in which the company is operating
4. Best Usage: of more use when you are analyzing stocks that are in the cyclical industry (like-Auto, Cement, Steel, etc.) Companies having one-time profit/charge can also be valued through this ratio. P.S ratio

Price to Book Ratio (P.B ratio)

1. compares the stock price with its book value per share (also refers to net worth), indicates the amount that each shareholder should receive if the company liquidates completely.
2. Best Usage : useful for Banking/NBFC stocks (provides a better picture of the current net worth of that bank.)
3. Drawbacks : almost no significance for software companies
4. Lower the ratio better is the investment opportunity.

Misconception among Investors : Low-priced stocks are cheap and high priced stocks are expensive, Investing in low P.E stocks is called value investing

Valuation techniques : Discounted Cash Flow method (DCF) : attempts to find out the value of a company today, based on projections of how much money it's going to make in the future, It is described as "discounted" cash flow because cash in the future is of less worth than cash of today

Easiest Way to Judge Valuation :

1. Comparing Valuation with its Own Historical Average : Sensex P.E below 15 is a golden opportunity for investing in the stock market
2. Comparing P.E with Average Growth Rate : Price to Earnings Growth (PEG) (= Price to Earnings ratio/ Earnings Growth rate.) -PEG ratio less than 0.5 indicates that the stock is undervalued and can be a great investment bet. PEG ratio greater than 0.5 but less than 1 indicates that the stock is either undervalued or reasonably valued, based on other parameters it can be a good investment bet.
3. If current valuation (P.E and P.B ratio) is less than the last five years average and the current P.E is less than half of the last three years average profit growth (PEG ratio < 0.5), then we can conclude that the company is undervalued and can become a great investment bet. If current valuation (P.E and P.B ratio) hovers around the average of the last five years valuation and current P.E is less than or equal to last three years average profit growth (PEG <= 1), then we can conclude that the company is reasonably valued. If the current valuation is either in the lowest or highest range of last five years range, then it requires serious attention. If current P.E is double of the last three years average profit growth rate (PEG >2) and the current valuation is in the highest band of last five years average, then the stock is overvalued. It is always better to avoid such stocks.

Best Time to Buy Stock : A great stock can be purchased even after 100% price appreciation. There is no best time to enter in high-quality stocks. If you can figure out an extraordinary business with great future potential, then it is never too late to buy. Timing is not required if you can spot a “true” gem. Even if you purchase a quality stock at the peak of bull-run, you won’t be disappointed over the long run. The only thing is that it should be a true “quality stock”. This statement will be clarified by the example of a well-known “high quality” stock; ITC.

Misconceptions to be Avoided

1. Stocks that are in 52-weeks high range are not safe investment. - *Its never too late to invest in great business*
2. Stocks that are near 52-weeks low range have greater potential to move up.

When to Sell a Stock? : Better Opportunities Available, Wrong Buying Decision, Valuation is Over Stretched/becomes too expensive, Change in Fundamentals (Business), Changes in Management, Develop a Pre-defined Exit Strategy While Investing in Stocks

Always exit at the first sign of trouble, It doesn't matter whether your investment is at loss or at profit

Deadly Mistakes to be avoided : Investing in previous bull market stocks, Holding losers too long, Selling winners too early, Selling to buy at lower level

Portfolio : Limited in Numbers but Diversified Across Sectors

Misconception Among Investors

1. Large cap stocks always offer safety and steady flow of return (Dividend yield – Quality small caps do well), NEVER divide your portfolio based on market capitalization.
2. Stocks that have already doubled in recent past have less potential to move up further.
3. Stocks that fall sharply must have to move up sharply

How to protect portfolio from market crash

Minor Stock Market Crash

1. Don't sell off your entire equity holdings to re-enter at a lower level - You may end up with selling at a lower level and buying at a higher level.
2. The reality is it is next to impossible for predicting short term market movement correctly and consistently. However one can predict long-term price movement of any individual stock based on the underlying business

Major Market Crash

1. You need to sell-off your entire portfolio much before such major stock market crash and seat in cash.
2. After the market crash don't invest in previous bull market stocks

Stocks to Avoid : High Debt Companies, Low Promoter Holdings and MicrocapsHigh Promoter Pledging (and increasing), Stocks Touching New Low, Too Much Popular Stock, Costly Acquisition

Warning signals about fee based advisory :

1. Avoid entities those are promising extraordinary return and asking for huge fees
2. Avoid entities those are not offering any logic behind stock recommendations.
3. Be aware of statements like "99% accurate jackpot calls" or like "100% accuracy level".

Important Lessons to be Learned

1. Start Investing as Early as You Can
2. Dare to Dream Big

3. Don’t Follow the Crowd
4. Don’t Blame Others
5. Appreciate but Never Criticize