

## Learn with DNA... Information overload

There were days when access to the unabridged annual report of Reliance Industries within a few days of its printing got a journalist an exclusive news story. The business media in India has come a long way since those days and now we have reached a stage where in news anchors broadcast information every minute.

There is an entire industry that has sprung up and whose only job is to make sense of all the financial and business data that is being generated. Analysts, market commentators, television shows hosts have an explanation for every rally, every sell-off and everything else that happens in between. And that does not mean that a particular rally or a particular sell-off happened because of the explanation being offered. First, the rally or a sell-off happens and then an explanation for it is offered, and there needs not be a link between the two.

Also, in their zeal to get the news and analysis to the audience before anyone else does, business media at times end up oversimplifying things. Also, at times, they end up magnifying the effect of stock market movements.



As Nassim Nicholas Taleb points out in his book *Fooled By Randomness*, "The market movements in the eighteen months after September 11, 2001 were far smaller than the ones that we faced in the eighteen months prior - but somehow in the mind of investors, they were very volatile. The discussions in the media of the "terrorist threats" magnified the effect of these market moves in the people's heads. This is one of the many reasons that journalism may be the greatest plague we face today - as the world becomes more and more complicated and our minds are trained for more and more simplification."

So, why are investors so cued in to business news all the time? To answer this question, we need to delve into the psychology of a short-term investor and a little bit of history. A short-term investor needs a reason to keep trading all the time. Trading for him is a game, which needs to be played, irrespective of the fact whether it is the right time to play or not.

Edwin Lefevre in his book *Reminiscences of a Stock Operator*, written in the voice of Jesse Livermore, one of the greatest speculators of all times, says, "There is a time for all things, but I didn't know. And that is precisely what beats so many men in Wall Street, who are very far from being in the main sucker class. There is the plain fool, who does all the wrong things everywhere, but there is a Wall Street fool, who thinks that he must trade all the time. No man can always have adequate reasons for buying or selling stocks daily - or sufficient knowledge to make his play an intelligent play."

### Post office deposit rates and features

■ Kisan Vikas Patra	
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Max. amount	No limit
Tax breaks	None
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Interest	8%
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	None
■ National Savings Certificate	
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
■ Public Provident Fund	
Interest	8%
Tenure	15-16 yrs
Min. amount	Rs 500
Max. amount	Rs 70,000 p.a.
Tax breaks	Section 80C deduction
■ Recurring Deposit	
Interest	7.5%
Tenure	5 yrs
Min. amount	Rs 10
Max. amount	No limit
Tax breaks	None
■ Senior Citizens Savings Scheme	
Interest	9%
Tenure	5 yrs
Min. amount	Rs 1,000
Max. amount	Rs 15 lakh
Tax breaks	None
Min. age	60 years
■ Time Deposit	
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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# Start early, however little you invest

That is the core advice for DNA Money reader Vikrant Ranade

Balvir Chawla



Vikrant Ranade, 29, is working with Countrywide as a system administrator. He is married and has two sons, Aaryan and Eshaan, who are twins. He has been working with this organisation for the past two years and believes he has a good future with the company. He is expecting a decent rise this year-end when his salary is due for appraisal. At present, he is drawing a salary of Rs 20,000 p.m. and expects a rise of around 30% in the next financial year. Due to the responsibilities and the purchase of a house, Vikrant is left with low savings.

### Financial goals

Vikrant is full of dreams and has the will to succeed. He believes that if he dreams big and plans for it, he will definitely achieve it. He plans to buy a car next year by selling off his existing car. He has his eyes set on making a second property, which he wants to be in the form of a penthouse. Also, being from a Brahmin family, he plans to hold his son's thread ceremony with pomp and fanfare, three years from now. He also has to plan for his children's education and his retirement.

### Present situation

Vikrant is drawing a salary of Rs 20,000 p.m. and his wife is drawing a

salary of Rs 2,000 p.m. The EMI for his house property at Panvel is Rs 9,272. This is at a fixed rate for a tenure of 20 years. He has an insurance policy for his kids for which he is paying a premium of Rs 2,717. The other financial details are as follows:

Investments	
Mutual funds	Rs 1,30,000 (Rs 1 lakh for kids' education)
Provident fund	Rs 20,000
FD & cash	Rs 15,000
Assets	
House	Rs 25,00,000 (Bought at Rs 15 lakh)
Valuables	Rs 1,50,000
Liabilities	
House loan	Rs 9,50,000

### Analysis of present situation

**Expenses**  
Vikrant is paying nearly 50% of his salary as EMI. But, over a period of time, this EMI will remain constant and his salary will increase. His expenses on self, accessories and telephone are around Rs 3,500, which is on the higher side. He should try and reduce these expenses and start with a monthly saving plan for investment, however small the amount. Starting a systematic investment plan with a good diversified equity fund would be the ideal way to get started.

He should try and avoid using his wife's salary and use this amount to save for a longer term.

### Insurance

Vikrant is inadequately insured. His insurance requirement is a minimum of Rs 25 lakh for which he can take a term



insurance cover, which won't cost him more than Rs 7,500 p.a. If Vikrant is not covered for mediclaim from his company, he should cover his family under a mediclaim policy for a cover of around Rs 3 lakh for the complete family.

### Achieving financial goals

**Purchasing car**  
Purchasing a car can be avoided till some basic investments and cushions have been created. He can probably defer the decision by a year and accumulate the amount to minimise the loan for the new car. At any point, all his EMIs should not exceed 35% of his salary. His salary increments can be used to fund the purchase

of his car. He should try and save around 75% of the increase, i.e. if his salary reached Rs 3.25 lakh, then he has an increment of Rs 85,000 and he should try and save around Rs 5,000 p.m. for the next two years to generate a corpus of Rs 1.50 lakh, assuming a return of 15% p.a.

### Kids' thread ceremony

Vikrant needs Rs 1 lakh in three years' time for the thread ceremony of his children. To reach this figure, he will have to save Rs 2,200 per month, assuming a return of 15% p.a. on the investments. He can start saving his wife's salary for this purpose and he will definitely reach a figure of Rs 1 lakh.

### Penthouse

This goal of Vikrant is 5 years away and assuming his existing house will appreciate @ 10% p.a. for the next 5 years, the value of his existing house will become Rs 44 lakh and his loan amount outstanding will be around Rs 8,50,000. So the amount he can generate from selling his house will be around Rs 31.50 lakh, which can be used as down payment and the balance can be funded through a loan.

### Conclusion

Small drops make an ocean. So, Vikrant should start small, remain disciplined and enjoy the fruits of his investments. A start has to be made and it is important for Vikrant to make the beginning as soon as possible. Once he gets into the habit of investing and controlling the expenses, he will have a more clear idea of investments and can also target his future goals and achieve them. Increments at any stage should be used to create assets besides any money coming in bonus or any other form.

### Assumptions

The recommendations have been made based on the information provided.

The writer is a certified financial planner based at Pune. Views expressed are his own and do not necessarily represent those of FPSB India. Feedback may be mailed to myplan@fpsbindia.org

If you would like to be featured and need a financial plan made by a qualified planner, mail to: my-money@dnaindia.net

## India has to show the way in futures

Sandeep Singal, co-head, institutional derivatives, Emkay Share and Stock Brokers, is a mechanical engineer turned wizard of high finance. Between 1996 and 2002, he was part of the core team at Bombay Stock Exchange that set up the derivatives market in India. "Hats off to the retail investors," says Singal, pointing out that while the trend the world over is of institutions creating derivatives markets and serving them to retail, the market in India has been developed by retail investors and given to institutions. In fact, the first Rs 4,000 crore daily turnover was only on the back of retail investments, he says, adding, it was only in 2004, when the Rs 5,000 crore mark was crossed, that the real flows from FIIs started coming in. Singal spoke to Sanat Vallikappen and N Sundaresha Subramanian on a host of issue pertaining to the stock market, particularly derivatives. Excerpts:

**What is your view on the introduction of Sensex futures in the US?**

It's a welcome step. My apprehension is that the experience of NSE listing its Nifty futures on Singapore exchange has not been very encouraging. The reason is that you need a market of unlike-minded people. You need people to buy and sell. In Singapore, mostly FIIs trade and they are like-minded people, I would say. Mostly block trade is reported instead of thorough liquidity. In India, a lot of retail investors and HNIs are pumping in the liquidity. In the absence of them, we had not seen the depth in these markets.

**It seems the BSE has appointed some market makers to boost the volumes in Sensex futures. Will this help?**

For last 8-9 months, the BSE is hovering around Rs 700-1,000 crore average volumes in Sensex Futures. There is concerted effort from the exchange by appointing some pseudo market makers, not market makers by regulation, to support the contracts. Retail interest is picking up. Lot of institutions also have now shown interest. There is an ETF launched on Hong Kong Stock Exchange on Sensex. There, Citibank is



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the market maker. With these products, they would like to hedge it back with Sensex futures. As and when, it catches the critical mass, there would be exponential growth. When that would happen is a difficult question to answer.

**Anything significant you have observed in the last few months?**

Generally, volumes used to be around Rs 55,000 crore. Three months ago, that level was crossed. Now, the volumes are typically around Rs 1 lakh crore. This was on the back of lot of liquidity and cash flows from FIIs. We are in uncharted territory now.

**NSE has introduced lot of new stocks in the F&O space. Have they contributed to this increase in volumes?**

In the new stocks that have been added, options are virtually illiquid. That is in line with illiquidity in stocks options. Stock options in general are illiquid, except a few like Reliance, Bhel and Infosys, etc. What I have seen in these counters, options get liquid towards the results season. Then people want to play on the volatility. The small caps or midcaps, there are very little

volumes.

### What about futures?

In futures, if you see them in relation to weightage of their market cap, they are contributing to their ability. Options, it is virtually zero.

**Is it the same case with the new indices also?**

The latest in the series is Midcap 50. Apart from Nifty, now there are five secondary indices. Their volumes are dismal. World over, people have tried and have not been successful. Similar experience was with single stock futures. India was the 9th country to launch single stock futures. Out of the eight that have launched before, seven have been failures. Only the Sydney stock exchange has seen some success and the stock exchange in Sweden has seen some action. I would say single stock futures and the secondary indices, India has to show the way to the world.

**In that context, how do you see the latest Sebi move introduce new derivative products?**

This is a very welcome step. I see long dated options, particularly with

six months to one year maturity, happening immediately. Mini contract could be another success. But there, they would have to revisit the floor limit of Rs 2 lakh that was mandated at the time of launch of derivatives in 2002 for launch of Rs 1 lakh or Rs 50,000 kind of contracts.

**A volatility index has also been proposed. With the option volumes low, will the calculation be difficult?**

This problem was faced by CBOE also. Initially, they will manage with one month liquidity. At-the-money options are pretty liquid in India. Any variable of volatility index in India calculated on one month contract will express a one month view. Fine, it's better to have some sentiment indicator than nothing at all.

**Any sector you like at the moment?**

Power is the best. Refineries, steel also look good. But these are largely commodity plays. One has to closely track the prices to take a view. Power is a more sacrosanct theme. It is not going to decline in one year or five years.

Let's talk percentage, for absolute gains can mislead

## Of Sensex, newspapers and middle school math

Vivek Kaul, Mumbai

Mathematics is not a subject favoured by most individuals. Their level of understanding becomes clear when it comes to deciding when to use percentages and when absolute numbers. Newspaper editors lead this list of confused souls. To know why read on.

"Largest single day gain for the Sensex," screamed most newspaper headlines on November 15, 2007. On November 14, 2007, the Sensex had closed 893.58 higher from the previous day's close.

Similar headlines were seen on October 24, 2007 and October 10, 2007. The Sensex had closed the previous day of trading higher by 878.85 points and 788.85 points, respectively. In each case, the Sensex had made a single-largest absolute gain till that point of time.

So, what's wrong in that? Well, newspaper editors seem to



have forgotten their middle school mathematics. Any gain or loss is always with respect to something else and hence needs to be expressed as a percentage of that.

When the Sensex rose 893.58

### Ranking the Sensex gains

Date	Absolute gain		Percentage gain	
	Change	Rank	Change	Rank
Nov 14, '07	893.58	1	4.69	64
Oct 23, '07	878.85	2	4.99	57
Oct 09, '07	788.85	3	4.51	70
Oct 29, '07	734.50	4	3.82	114
Sep 19, '07	653.63	5	4.17	94
Oct 15, '07	639.63	6	3.47	154
Jun 15, '06	615.62	7	6.89	18
Oct 03, '07	518.42	8	2.99	246
Jun 09, '06	514.65	9	5.54	37
Oct 26, '07	472.28	10	2.52	393
Mar 08, '07	469.60	11	3.73	122
Jun 30, '06	447.09	12	4.40	123

points, it was with respect to the previous day's close of 19035.48. Therefore, in percentage terms, it went up by 4.7%. Now, a single day gain of 4.7% is not small by any stretch of imagination. But, it isn't as huge as it is made out

to be, either. In terms of percentages, this was the 64th highest single-day gain. Similarly, the gains on October 23, 2007 and October 9, 2007, were 57th highest and 70th highest, respectively.

Of the 12 largest absolute gains (see table), 9 have come in 2007 and the remaining three in 2006. But, rank them in percentage terms and not one of them ranks in the top 10. In fact, among these 12, the highest rank in percentage terms is taken by the 615.62% gain on June 15, 2006 - at a poor 18th.

It doesn't take a genius to understand that as the Sensex goes higher, a small percentage increase mean a larger gain in absolute terms. Let us take an example. The highest single-day absolute gain so far has been 893.58. From the previous day's close of 19035.48, this was a rise of 4.7%. Now, say the market had gone up by 893.58 from the previous day's close of 8935.8. The same absolute gain would have meant a rise of 10%. If the Sensex were to rise by 893.58 from a level of 30,000, as and when it gets there, it would mean a rise of only 3%.

Surely, our editors can be expected to remember such simple mathematics.

From their point of view, however, "Largest single day gain for the Sensex", makes for a much sexier headline than "Sensex sees 64th largest gain" and is likely to get more people to read the paper. Besides, they know that all other newspapers will do the same, so they might do so as well.

John Allen Paulos writes in his book *A Mathematician Plays the Stock Market*, "Overreactions are abetted by the all-crisis-all-the-time business media" trying to explain this phenomenon. But investors shouldn't really get carried away by this. "Just as beauty and academic quality don't change as rapidly as ad hoc lists and magazine rankings do, so, it seems, the fundamentals of companies don't change as quickly as our mercurial reactions to news about them do," writes Paulos.