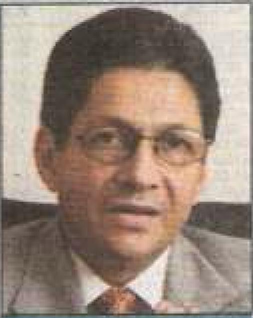
irrational **markets**

Concentrate on picking up value

All of a sudden, market sentiment has swung from excessive optimism to subdued pessimism. This is interrupted by a few spells of hope, when the markets rebound on some days, only to correct later. They go on offering hope, now to bulls, now to bears. This is one way to identify cheaters' rallies. At present, investor perception is changing. Expectations built into the prices of stocks are waning. Investors are now looking only at negatives. It is not as though these didn't exist before, but today, they have the attention of investors and the media. All available information is negative. In spite of this, when the indices take a U turn and rise, investors forget their original fears, and greed drives them to enter the markets.



penny **wise**

PARAG PARIKH

Let's understand the nature of the stock markets. When there's widespread optimism—as was the case in 2006 and 2007—every negative factor is neglected. We had asset inflation, with the stock markets and real estate markets going up by leaps and bounds. Commodity markets were also soaring. But inflation was under control. Can that happen? And is it sustainable? Now the inevitable has happened, and it should not surprise us at all. Fears about a US subprime crisis surfaced in mid-2007. A dangerous trend was evident. But we ignored it, wishing it would go away. Of course, it took its toll in early 2008, and the financial markets felt the tremors. The current news about Fannie Mae and Freddie Mac, both AAA-rated companies, borrowing at higher interest rates equivalent to those paid by companies rated five notches below, is bad news for the global financial markets.

On the domestic front, reports are flowing in about the delayed monsoon and about drought in parts of India. We had good monsoons in the last six to seven years, and hopefully this year, too. But it's mid-July, and the monsoon has played truant. The situation in the domestic financial markets is scary, too. When we had lower interest rates, we saw the abuse of capital. The bullish stock market led to paper profits, which were diverted to real estate. Lower interest rates encouraged people to borrow and to buy inflated assets. The rise in interest rates and the fall in the stock markets has ensnared people and corporations in a debt trap. Rising interest rates will increase EMIs from 15 years to as much as 35 years. Just look at newspaper advertisements: big corporations are selling real estate through closed auctions. Participate in one and see how prices have fallen.

A four-year bull run cannot just vanish in four months. However, such times will offer tremendous opportunities for investors. Attractive valuations have become a reality. Of course, you must be a long-term investor, as these pains could linger. Don't worry about where the index is going, or what news is coming. Concentrate on picking up values: good management, good business model, and a healthy balance sheet. Are you paying the right price? And what is the right price? Answer: one with no built-in investor expectations. Investing is all about buying when everyone is selling. That's how values emerge. When the markets fluctuate daily, based on news of oil prices, global market trends, political developments and quarterly results, it is a sure sign of weak sentiment.

Parag Parikh, Chairman, Parag Parikh Financial Advisory Services, specialises in behavioural finance. His column appears in the second week of every month