What is equity? Understand its right meaning to reap the Benefit

What is equity? This question is running in every Indian investor's mind. Why?

Because equities have done very well in past 10, 20, 30 years, but investors are not able to make money.

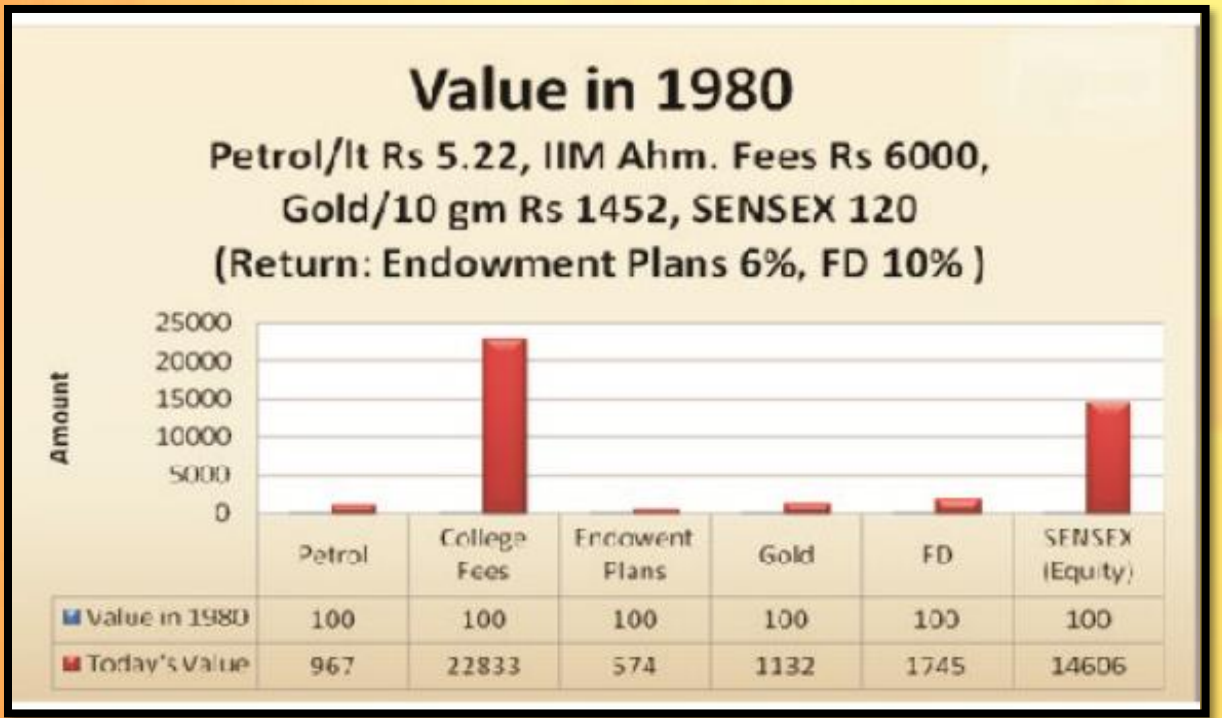
What is an equity – a share, market, a fund or an asset class?

Yes in this article we will discuss everything related to equity that will help you in creating wealth. A Few months back we wrote an article related to short term and long term investments, So read it to understand the right meaning of equity & reap the benefit.

If as a Financial Advisor we ask you to invest in Equities or Equity oriented Mutual fund, the typical reaction is – We don't want risk in our investment but we want decent returns too. Even though the equity share has given the wonderful returns over long run not only in India but the world over, Indians are not really comfortable investing their money in equities. Less than 6% of their investments are in this asset class ,whether directly or indirectly.

Just to give you comparison how equities delivered returns over last 30 year, look at the graph below.

The graph shows you how Rs. 100 invested in a different asset class fared over the last 30 years ending March 31st 2010.



What is Equity? Let's understand, what exactly Equity is all about…….. Equity is nothing but ownership; ownership in Business. For Ex. If you hold 10 shares of XYZ Company out of the total 1000 shares floated by the company – you are 1% owner in XYZ's business. So if XYZ will make a profit you will get your share from dividends and price appreciation, but if this company makes losses your capital will go down (that will be reflected in the stock price).

A general question – If we ask you to start your own new business, how much time do you think you would like to give before you start thinking whether it's really worth it or not1 Week, 1 month, 1 year. You must be thinking that we are joking. Ideally, we should think for some long time when we enter in any legitimate business. But this common principle, we don't really apply when we invest in other's business which can be done through shares/equities.

When we buy equities, we start looking at the price next day or next week. For many who call themselves investors, long run is 1 month. But do you think the management of the business of which we buy shares really looks at their business growth in such a short period.

In equities, the rule of Farming applies

This basic rules state that:

1. ***You first have to sow a seed.***
2. ***Keep watering it for it to grow.***
3. ***Wait for some time with patience.***
4. ***With the passage of time, you will get the fruits of your hard work and patience.***

But when it comes to equities, we think that **HAATHON MEIN HI SARSO UGTI HAI**. We want a good return in a short time.
How many of us really think of equities for long horizon.? We keep the gold for generations. Grandparents go for bank fixed deposits for their grandchildren, but no one invests in share of banks, say HDFC Bank for their kid's marriage. And, no one plans to invest in equity mutual fund for their retirement.

Fundamental Investing & Speculation

Equity give you two kinds of return, one is speculative and another is fundamental growth. 95% of the investors in shares are here for speculative gain, that is a gain from the short term price movement of shares. They start TIMING THE MARKET rather giving TIME IN THE MARKET. This approach for short term gains is the real cause of the loss. Investment in the long run is not only rewarding, but also beats inflation by a good margin and creates clueless, but think about it for next 5 years, 10 years. We know that you are aware of the answer.

Risk Involvement

Now people call equity risky. Unfortunately risk is not understood by many investors. In the short run, risk is in the volatility of price of underlying asset i.e., how much it can rise and fall given a period of time.

But in long run risk is not volatility, but the risk is to maintain the purchasing power of your money.
Look at the price of petrol in the last 30 years (in chart 1) and then compare it with your return in FDs, gold, Endowment or Money back Plans.

Why people don't make money in Equities?

Looking at the graph above, it must be clear that equities do give returns. But the question still remains unanswered that if Equity gives returns, Why people don't make money out of equities. The answer lies in their EMOTIONS.

The two basic emotions Greed & Fear will make you feel comfortable when the markets are going up and feel disheartened when the market goes down, even though one really don't need to sell at that time. Always remember that equities is a long term investment and after you invest if emotions are making you restless, think about forgetting this investment.

Checking daily profit or loss and anticipating the future growth has no meaning and is a futile exercise. In the end, invest in equities, but as a long term investor and partner the Indian Growth Story.