The Fidelity Guide to Equity Investing

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WORLDWIDE INVESTMENT

Equity investing - dispelling the myths

Investing in equities or shares may seem complex and only for those with plenty of money or a nose for hot tips. It's time to throw away these thoughts!

There are thousands of stock market investors out there, just like you. Some are single, others have a family. Some own the roof over their head and some rent a home. Some have retired while some invest a bit of their salary every month. What they all have in common is a desire to make more of their money.

What it is

Equity investing simply involves buying a part of a company. For example, if you bought shares in Company X, it would make you one of the company's owners. You would gain a stake in any success it achieves and if the company is not as successful as was expected, then the value of your shares would decrease accordingly.

You can buy equities through a stock broker and directly invest in individual companies. Or you can choose to invest in an equity mutual fund. This means your money is pooled with other investors' contributions, allowing you to buy shares in a wide range of companies.

What it is not

Equities are not a sure-fire way of making a fast buck! Many investors do increase the value of their money, but there is no guarantee of gains. You need to be prepared for a few ups and downs – as that's simply the nature of stock markets – but the long-term rewards could be well worth your while.

Five key principles for successful investing

Investing in equities is like riding a stallion. If you don't harness the horse properly, you'll have a hard fall. But do it well and it's the best way to get to your destination.

Here are five key principles for successful equity investing. Follow them diligently and you could be on your way to harnessing the significant potential that equities offer.

Contents

1.

Decide how much risk you can tolerate

Consider this: the BSE Sensex has grown from 100 points in 1979 to over 17705 (31/10/2011). That's a compounded annual growth of over 18% a year - returns that other investments such as bonds or cash may not easily match.

When impressive returns like these are possible, why would Peter Lynch (quoted below) think the stomach is the key organ for investors? Well, the growth in the Sensex didn't happen overnight or in a regular manner. In fact, eight of these 32 calendar years saw negative returns, sometimes as bad as -52.45% (31/12/07 to 31/12/08) and -20.85% (31/12/94 to 31/12/95). Each time the market drops, many investors panic and stray from their plan. (Source: BSE and Fidelity)

In other words, you need to appreciate that risk is an essential part of the experience of investing in equities.

To get a good feel for how much stomach you have for equities, ask your Investment Adviser to take you through a risk profiling exercise. This will show how much risk you can tolerate.

"In many ways, the key organ for investing is the stomach, not the brain. What is your stomach going to do when an investment your brain selected declines for a year or two?"

Peter Lynch, Research Consultant, Fidelity Management & Research Company and former Fund Manager of Fidelity Magellan Fund.

The following factors will all have a bearing on the result.

Your time horizon – Decide for how long you can remain invested in equity mutual funds before you need your money for important outgoings, such as buying a house, paying for your children's higher education or funding your retirement. As a general principle, equity investments should only be considered if your time horizon is over five years.

Your attitude to losses – How do you think you would feel when your investments get hit temporarily during a volatile twist of the market? If you are the sort to lose sleep at times like these, equities are best avoided.

Your investment objective – Think about what your primary objective is. Is it to preserve the value of the savings you have painstakingly built up over the years or is it to increase your savings into something far more substantial over time?

Your Investment Adviser will discuss these and other important issues with you to get an idea of your appetite for risk. You can then decide on a mix of assets that would suit your particular circumstances.

2. Don’t let the Sensex guide your senses

Investors often form their views on equities by looking at the BSE Sensex. Devotees of equities argue that this shows they yield superior returns over the long-term. But the sceptics point out that the Sensex crossed 4,600 way back in 1992. It has since gone up and down several times. For example in January 2005 the Sensex was trading at around 6,600 and one could say that a 43% increase in 12 years (around 3% per annum) wasn't much to show for the last 12 years.

(Source: BSE)

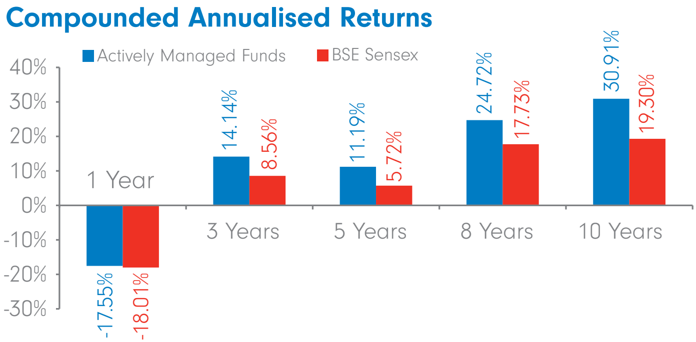
The fact is that an equity market is more than a benchmark index. The BSE Sensex only represents 30 actively traded large companies. The Indian equity market offers an immense variety of other investment opportunities. Active equity fund managers have demonstrated that they can look beyond the index and spot companies that can deliver much better returns for investors.

The graph alongside shows the compounded annualised growth of the BSE Sensex, compared with the returns from actively managed funds over five different periods up to ten years.

Over each of these periods, actively managed funds have outperformed the Sensex. This is the benefit of active management.

Active fund managers make their own decisions about which shares to buy. Some use statistical analysis; others follow fashion.

Passive or index-tracking funds, on the other hand, attempt to replicate an index, such as the Sensex, by holding the same stocks and in the same proportions.



Source: Verity Analytics. Compounded annualised returns as at 30/09/2011. Figures are based on the combined average performance of the 10 largest open ended diversified equity funds (as at 30/09/2011) having a track record of over 10 years. Past performance may or may not be sustained in the future.
(Source: Verity Analytics).

When you invest in actively managed equity funds your returns are dependent on the stock selection skills of the fund manager. Active management has worked well in the Indian market and there appears to be no reason why it should not continue working as well in the future.

A passive or index-tracking fund holds stocks not because they're worth investing in, but because they're in the index. And it has to hold them as long as they stay in the index, even if they are over-priced or on their way down. An actively managed fund, on the other hand, holds a stock because the fund manager wants it in the portfolio.

Your Investment Adviser will be able to help you select actively managed equity funds that are right for your particular circumstances and goals. You'll be investing in equities without having to worry about where the Sensex is, or where it's likely to go.

3.

Don't put all your eggs in one basket

Once you set your investment objectives and establish your tolerance for risk, your Investment Adviser, in all likelihood, will make suggestions that you spread your savings across the main asset classes – equities, bonds and cash.

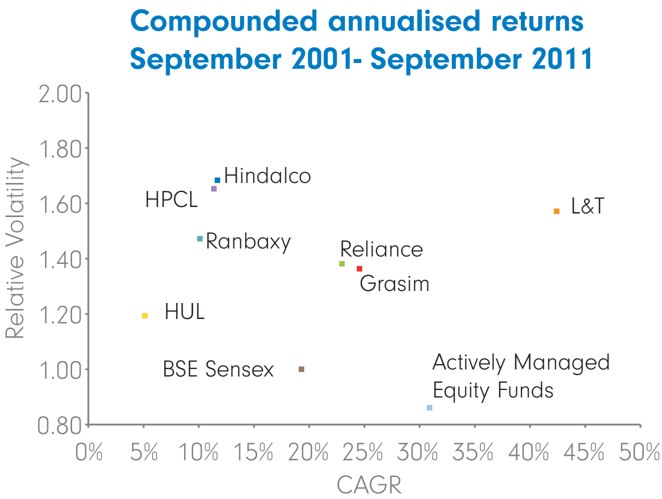
This principle of diversification holds true within equities as well. Investing across a range of companies, sectors and even markets ensures that you are not reliant on the performance of any one type of equity and hence, do not run the risk of having "all your eggs in one basket".

Diversification within equities should ideally be considered at three levels:

- Across stocks
- Across sectors
- Across markets

Across Stocks

The graph demonstrates that over a 10-year period, actively managed equity funds have not just delivered superior earnings but have also managed to do so with much lower volatility. A well diversified fund should have a good mix of "large cap", "mid cap" and "small cap" stocks, as different market conditions favour different kinds of stocks.



Source: NSE, Verity Analytics. Compounded annualised returns from 28/09/2001 to 30/09/2011 of the 10 largest open-ended diversified equity funds (as at 30/09/2011) having a track record of over 10 years. Past performance may or may not be sustained in the future. Adjusted NAVs used for calculations (Source: Verity Analytics)

Across Sectors

You could try predicting the next "sunshine" sector and put all your eggs into that basket. If you get it right, you could certainly earn more money than any diversified equity fund. However, it is rare for one sector to consistently outperform all other sectors over time, and if the so-called sunrise sector that you invested in ends up performing poorly, you could end up losing a lot of money.

It's always prudent to consider a well diversified equity fund that invests across sectors. Demonstrated in the chart below, you will notice that returns from the BSE 200 index (which has a broad representation across sectors) have been less volatile than individual sectors.

Industry sectors 2005-2010

2005	2006	2007	2008	2009	2010
BSE Consumer Durables 114.51%	BSE Capital Goods 56.43%	BSE Metal 120.51%	BSE Health Care -32.80%	BSE Metal 233.68%	BSE Consumer Durables 67.93%
BSE Capital Goods 93.66%	BSE IT 40.87%	BSE Capital Goods 116.41%	BSE IT -50.57%	BSE IT 132.78%	BSE Health Care 34.19%
BSE IT 42.75%	BSE Oil & Gas 40.11%	BSE Oil & Gas 114.35%	BSE Oil & Gas -54.42%	BSE Capital Goods 104.26%	BSE IT 31.59%
BSE Oil & Gas 40.14%	BSE 200 39.58%	BSE Consumer Durables 93.93%	BSE 200 -56.36%	BSE Consumer Durables 97.80%	BSE 200 15.33%
BSE 200 33.80%	BSE Metal 39.39%	BSE 200 60.03%	BSE Capital Goods -64.92%	BSE 200 88.51%	BSE Capital Goods 7.67%
BSE Metal 4.43%	BSE Health Care 21.74%	BSE Health Care 16.43%	BSE Consumer Durables -72.39%	BSE Oil & Gas 73.07%	BSE Oil & Gas 1.25%
BSE Health Care 1.84%	BSE Consumer Durables 9.27%	BSE IT -14.02%	BSE Metal -73.86%	BSE Health Care 69.18%	BSE Metal 1.13%

Source: BSE, Credence Analytics.

Across Markets

Diversification across various markets (subject to following relevant local regulatory norms), adds a further dimension to your portfolio of investments and your endeavour to control risk. Stock markets in different countries do not always move in tandem. As you will see in the following chart, the Indian equity market has been a great performer in some years - but has also been lower in others.

World market returns 2005-2010

2005	2006	2007	2008	2009	2010
Japan 42.94%	India 46.47%	India 52.14%	UK -31.55%	India 91.51%	India 14.74%
India 40.17%	EMU 18.97%	EMU 5.29%	USA -38.49%	USA 24.20%	USA 13.18%
Far East 39.03%	World 13.52%	USA 4.06%	World -40.03%	EMU 23.06%	UK 8.47%
EMU 22.41%	USA 13.18%	UK 2.94%	Japan -43.54%	World 22.82%	World 7.83%
UK 15.99%	UK 10.70%	World 2.81%	Far East -44.81%	UK 22.28%	Far East 1.03%
World 13.74%	Far East 8.02%	Far East -6.86%	EMU -46.49%	Far East 12.87%	EMU -0.44%
USA 3.80%	Japan 6.09%	Japan -11.27%	India -56.72%	Japan 7.25%	Japan -1.24%

Source: Reuters, Credence Analytics. Based on MSCI indices in local currency for eash year.

An ability to diversify across markets helps to smoothen out volatility to some extent. Diversification gives you the "upside" of equity investing, while controlling inherent risks.Your Investment Adviser can help you select equity funds that are truly well diversified.

4.

Think time in the market, not timing the market

When share prices start to go down or seem static, it can be tempting to sell your investments and wait until things improve.

Or you may delay making an investment until you feel more confident that prices are going up. In theory, "market timing", as this is known, is attractive. But in practice it is rarely successful.

Taking a long-term view

We examined the average performance of actively managed mutual funds in India since September 2001. Over this time, there were 61 possible five-year periods, each starting one month apart and no investor taking a five-year view would have made a loss. Investors who sold earlier might have lost money. The bottom line: the longer you stay invested, the better the chances that your investment will grow.

One year		Three years		Five years	
% of one-year periods where investors		% of three-year periods where investors		% of five-year periods where investors	
Made Money	Lost Money	Made Money	Lost Money	Made Money	Lost Money
87.16%	12.84%	96.47%	3.53%	100.00%	0.00%

Source: Verity Analytics. 28/09/2001 to 30/09/2011. Rolling returns are based on the combined average performance of the 10 largest open-ended diversified equity funds (as at 30/09/2011) having a track record of over 10 years over one, three, five years at one-month start intervals.
Past performance may or may not be sustained in the future.

It's too easy to miss the gains

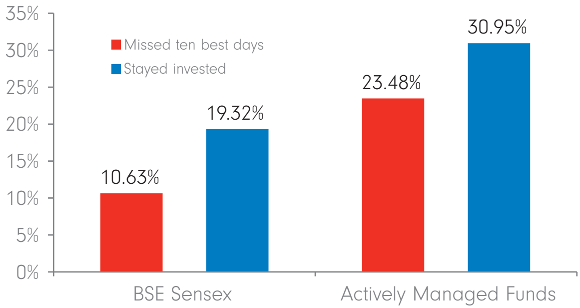
Just as the big falls in stock markets tend to be concentrated in short periods, the best rises happen quickly. And since these large gains often occur in the early days of an upward trend, an investor trying to time the market is highly likely to miss out.

Fidelity has looked at the returns from the Indian market (both actively managed funds and the BSE Sensex) between September 2001 and September 2011. Our analysis shows that missing just a few of the best days can certainly affect performance.

Missing the ten best days over this ten-year period would have cut the average annual market return from 30.95% to 23.48% for actively managed funds. Similarly your annual returns from a fund tracking the BSE Sensex would have dropped significantly from 19.32% to 10.63% if you hadn't stayed invested throughout. So, far from minimising investment risk, market timing seems to be a high-risk strategy.

And it is clear that worrying over when to invest makes very little difference over the long term. What matters is time, not timing.

Compounded annualised returns September 2001- September 2011



Compounded annualised returns from 28/09/2001 to 30/09/2011.
Figures are based on the combined average performance of the 10 largest open-ended diversified equity funds (as at 30/09/2011) having a track record of over 10 years. Past performance may or may not be sustained in the future. Source: Verity Analytics.

5. Invest systematically - through the ups and downs

One method of successful equity investing is to set up a Systematic Investment Plan (SIP) and stick to it through all the ups and downs of the market.

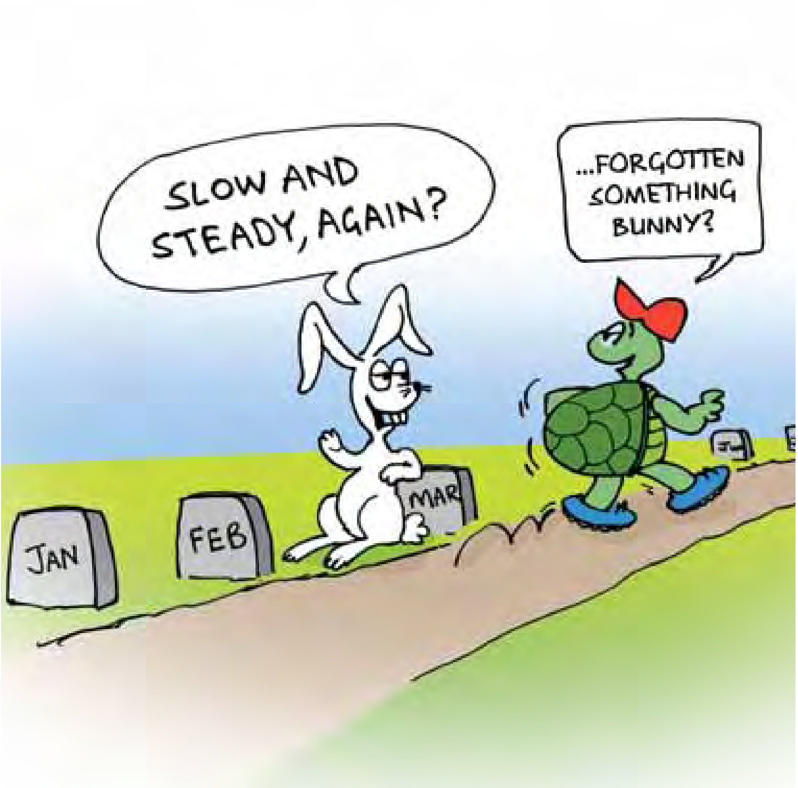
The easy and affordable way to build your investment

If you don't have immediate access to a large amount of ready cash, investing a regular amount each month can help you build up a lump sum and benefit from the growth potential of the stock market.

Saving on a regular basis in this way is easy as you treat your investment as part of your monthly budget. What's more, you can benefit no matter how the markets are performing:

- If the market goes up, the units you already own will increase in value
- If the market goes down, your next payment will buy more units

Saving regularly allows you to capitalise on a phenomenon called "rupee cost averaging", illustrated in the following page.


SLOW AND STEADY, AGAIN?
...FORGOTTEN SOMETHING BUNNY?
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The table below compares the returns achieved by a lump-sum investor and someone who saves the same amount every month for six months.

The regular saver finishes the period with an investment that is worth more than that of the lumpsum investor – even though the starting price, finishing price and average price are exactly the same. It sounds unlikely, but it's true. Check the figures for yourself!

The power of rupee cost averaging

		LUMP SUM INVESTOR		REGULAR SAVER	
Month	Unit Price (Rs.)	Amount Invested (Rs.)	Units Bought	Amount Invested (Rs.)	Units* Bought
1	20	60,000	3,000	10,000	500
2	18	-	-	10,000	556
3	14	-	-	10,000	714
4	22	-	-	10,000	455
5	26	-	-	10,000	385
6	20	-	-	10,000	500
Total invested (Rs)		60,000		60,000	
Average price paid (Rs)		20		19	
Total number of units bought		3,000		3,110	
Value of investment after six months (Rs)		**60,000**		**62,200**	

This example uses assumed figures and is for illustrative purpose only.* Fractional units ignored. There is no guarantee that the cost averaging will result in better returns that lump-sum investing.

6. The Effect of Monthly Saving

Regular contributions can soon grow in to a substantial amount. The graph shows cumulative returns from a monthly investment of Rs 1,000 for the past ten years.

The total amount invested by the end of the period as indicated by the red line is Rs 1,20,000. The blue line shows the returns generated if this money was invested in a fund tracking the BSE Sensex, while the green line shows what the returns would have been if it was invested in actively managed mutual funds. At the end of the period the investment in managed funds would have grown to Rs 4,41,557 as compared to Rs 2,73,762 from the Sensex. But what's interesting to note is that there was a long period when the Sensex returns were lower than the amount invested. In contrast, the returns from actively managed funds scarcely dropped below the amount invested.

Source: Verity Analytics. Cumulative returns from 01/10/2001 to 30/09/2011. Figures are based on the combined average performance of the 10 largest open-ended diversified equity funds (as at 30/09/2011) having a track record of over 10 years. Past performance may or may not be sustained in the future. Source: Verity Analytics

Notes:

We're here to help

Fidelity has a long history of helping people meet their financial goals. We have a range of brochures about our products and services and a number of free guides on key investment topics. Please contact us if you would like copies of any of these publications or more information.

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