Investing in the Stock Market

In the last article we spoke about how you could invest in the primary market and secondary market. The Stock Market has the ability to outperform any other investment asset class in the longer term. Even though the benefits may fluctuate in the short term, in the longer term stocks have been the most beneficial investment amongst the others. A person can engage in stock market investments as long term or short term investments.

This article we will give you some ideas to invest in the right way with the objective of creating wealth in the secondary market.

Long Term Investing

Maintaining a Diversified Portfolio

Risk is an integral part of investing and you simply can't avoid it, so it makes sense to find a way to deal with it. A core technique of savvy investors is to reduce risk by never putting all their eggs in one basket. In investment jargon this is called diversification. That is to put your money into a variety of investments to reduce risk and choose investments that behave differently, so if one does poorly the others might do better.

For instance, make sure you do not invest all your money in one single sector. You can spread your investment across several different sectors and pick stocks from various sectors. The companies listed on the CSE are divided into 20 sectors comprising of Telecom, Banking, Finance & Insurance, Beverage Food and Tobacco, Hotels & Travels, Manufacturing etc., You need to ensure that you understand each company's business model and the exposure to business and financial risk before making an investment decision. In depth knowledge and access to research data pertaining to sector dynamics, competition, key success factors, driving forces, government policies, global trends etc will no doubt help you to better understand the future direction of the respective industries/sectors. Your investments should thus be divided among the sectors that will offer relatively stronger growth prospectus.

Another way to diversify risk would be to spread your money among various classes of assets such as in Treasury bills, land and gold rather than investing all your money in stocks. Almost all investments can be grouped into one of three basic asset classes.

- Cash and equivalents – they are safe short-term investments like Treasury bills that can be quickly and easily turned into cash
- Fixed –income investments – they are bonds or debentures which provide regular income to the investor with limited risk to the money they invest
- Equity investments – like stocks which are riskier investments that offer greater potential for your money to grow over the long term

The allocation of funds in to different asset classes could be done at your discretion. If you are a risk taker then increase your exposure to equity with an asset mix of 70:30. (Ratio can vary from person to person) If you are risk averse, then you could allocate more funds into fixed income assets whilst channeling a smaller percentage into equity (stock market). You can set the right mix either on your own or with the help of a financial advisor. How much you allocate to each of these will depend on your answer to the question: “How much risk am I comfortable with?”

Timing of Investment

Once you've decided what your investment portfolio should look like, you can take the initial steps of investing. First and foremost, you should approach a suitable stockbroker and open a Central Depository System (CDS) account for him/herself via the stockbroker. At the time of initial investment, it is advisable that you do not invest all your money in at once. You should invest your money gradually in the market in order to minimize any market timing risk. Once you purchase shares of companies you are interested in, make sure you review them at least once a week and compare them with your initial investment.

Sustaining Your Portfolio

Review your portfolio regularly and add any securities in the areas in which you want to increase exposure. These additional securities can either expand the number of securities you hold or be added to existing holdings. By maintaining your portfolio as such, you would realize in a couple of years that it has become a substantial investment to fund your retirement, pay for a second home, or meet whatever goals you set when you started your investing journey.

Presented above are a few tips for investors on how to benefit from stock market investing in the longer term. The section below would focus on how an investor can succeed in the stock market through short term trading.

Short Term Trading

Short term trading can be a high risk, high return option. You should clearly understand the risks and rewards of each transaction if attempting to profit in the short term. You should also possess the skills of identifying best deals and safeguard yourself by unexpected losses.

Most of us assume that by following the events of the market at the end of the day, we would be sufficiently updated to make good decisions in the market. Yet what we don’t realize is that by the time we find out the information, the market has already responded for these facts and events. Thus you should be mindful of the following tips suggested by experts in the field, in order to make a better decision.

Step 1: Watch the Moving Averages

A moving average is the average price of a stock over a specific period of time. The most common time frames are 15, 20, 30, 50, 100 and 200 days. The overall idea is to show whether a stock is trending upward or downward. Generally, a good candidate will have an increasing moving average that is sloping upward. If you are looking for a good short term investment, you want to find an area where the moving average is flattening out or declining. Your stockbroker will advice you on this.

Step 2: Understand Overall Cycles or Patterns

Usually the markets trade in cycles, which makes it important to watch the calendar at particular times. Cycles can be used to traders' advantage to determine good times to enter into long or short positions.

Step 3: Get a Sense of Market Trends

If the trend is negative, you might consider doing very little buying. If the trend is positive, you may want to consider buying more. The reason for this is that when the overall market trend is against you, the odds of having a successful trade drop even more.

You should use a good source of information

In order to trade in shares, investors must be provided with information which affect the companies they are interested in, whether selling, buying or holding those company shares.

The main source of information are,

a. Publications by the Colombo Stock Exchange (CSE) or the web site www.cse.lk
b. CSE branches in Matara, Kandy, Kurunegala, Negombo and Jaffna
c. News papers and Journals
d. Radio and Television
e. The Quarterly and Annual Reports
f. Stock Brokers, their branches and their publications
g. professional investment Consultants

Investment advice from stock Brokers

When you trade in the secondary market you should obtain advice from your investment advisor.They are equipped with research reports and other analysis with regards to stocks. Basically they use quarterly and annual reports of companies including financial analysis to prepare research reports.

You should take the final investment decision

Stock brokers are doing only the secondary market trading. That is stock buying and selling for the clients. Stock broking company/advisors are not responcible for the capital loses due to price fluctutations of the particular stocks. For example, if you placed the order through your broker to buy 100 shares of ABC campany at the price of 20 rupees per share. After a few weeks the price of that share goes down to Rs.15 . The investor will have to bear the loss of the price reduction of Rs. 5 per share.On the other hand if the price goes up to Rs. 30 the investor will be able to enjoy a capital gain of Rs. 10 per share.

You should pay attention to your investment portfolio regularly

Price volatility or price fluctuation is common in any stock market. Different factors affect share prices. Hence, your stock portfolio prices will goes up and you can sell securities or hold the securites further for better capital gain and other benefits. If stock prices goes down you could keep it until the price rises.

Be satisfied with the return you get from investing

You will recieve different types of benefits from long term investments in the stock market. If you hold the securites for a long time period you can recieve capital gains, dividends, right issues, free shares etc. When the share prices go up you will have to make a decision to sell the shares at a certain price. You may not be able to maximize your profits but you need to be satisfed with the capital gains you receive from selling your shares.