Beginners guide to Equity Investments

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Beginners guide to Equity Investments:

Investing in the equity market seems to be challenging for many investors who are new to this field. But the functioning of the stock market is not as tangled as it may sound to a new investor. Once the investors learn few basic things before they start investing in the share market, they will be able to have a grip on the field and can perform better. Prior to start investing they must know a few things such as what equity investment is, how it works and how to start investing in the equity market. Here is what you need to know about equity investment.

What is Equity?

Equity represents the value that would be returned to a company's shareholders if all of the assets were liquidated and all of the company's debts were paid off.

Two ways of approaching Equity Investments by the investors:

- ### Growth Investing:

Investors in this kind of investing seek companies that offer strong earnings. Growth stocks represent companies that have demonstrated better-than-average gains in earnings in recent years and that are expected to continue delivering high levels of profit growth, although there are no guarantees. "Emerging" growth companies are those that have the potential to achieve high earnings growth, but have not established a history of strong earnings growth.

The key characteristics of growth investing are as follows:

- **Higher priced than broader market.** Investors are willing to pay high price-to-earnings multiples with the expectation of selling them at even higher prices as the companies continue to grow
- **High earnings growth records.** While the earnings of some companies may be depressed during periods of slower economic improvement, growth companies may potentially continue to achieve high earnings growth regardless of economic conditions
- **More volatile than broader market.** The risk in buying a given growth stock is that its lofty price could fall sharply on any negative news about the company.

Value Investing. Investors in this value investing seek stocks that appear to be undervalued in the marketplace. Value fund managers look for companies that have fallen out of favour but still have good fundamentals. The value group may also include stocks of new companies that have yet to be recognized by investors.

The key characteristics of value investing include:

- **Lower priced than broader market.** The idea behind value investing is that stocks of good companies will bounce back in time if and when the true value is recognized by other investors
- **Priced below similar companies in industry.** Many value investors believe that a majority of value stocks are created due to investors' overreacting to recent company problems, such as disappointing earnings, negative publicity or legal problems, all of which may raise doubts about the company's long-term prospects.
- **Carry somewhat less risk than broader market.** However, as they take time to turn around, value stocks may be more suited to longer term investors and may carry more risk of price fluctuation than growth stocks.

Investment Risks an investor should know :

Investing your money and dealing with the associated risks is a great challenge that every investor must accept in order to reap higher returns. In order to key out and minimize the risks it is vital to know the following type of risks applicable to investments.

Market Risk

This risk is associated with the movement in the prices of stock that commonly affects the market as a whole. There are many factors that cause market fluctuation, and natural calamity is one of them. Other factors are the phase of the market bull or bear. The rising and falling prices of the stocks and bonds determine profit and loss of the investors. If the market is in its bear phase, the downside risk is comparatively low and on the contrary if it is in bull phase the downside risk is more as the market can crash anytime.

Socio Political Risk

Change in government policy, political unrest, international issues (war), elections and change of the government are some of the important elements that affect the market stability. This instability may impose a huge risk on money and investment.

Business Risk

The market value of shares depends upon the performance of that stock in the market. If the investor have invested in the company that unfortunately isn't doing well, the market value of that investment will rapidly go down. When they invest in any company or enterprise, there are chances they may suffer loss or face bankruptcy. The risk associated with such investments may be little or in some cases very high. One common way to avoid such risks is to create a diversified portfolio.

How to pick good stocks?

Earnings per Share (EPS): When you research a stock, the first thing you should look at is the Earnings per Share (EPS). This is the

amount of profit the company is making on a per share basis. Market appreciates stocks which have a growth in EPS while it reacts negatively for stocks with stagnant or reduction in EPS.

Dividend yield: A dividend is a cash payout to shareholders, usually an annual payout by profit making entities. A stable or increasing dividend means the company has good cash flow and a positive outlook for the future. A decreasing dividend usually means the company is trying to keep some cash on hand for other expenses, possibly a sign of tough times ahead. One indicator of a good stock to buy is a high dividend yield. The yield is the yearly dividend as a percentage of the stock price. A high yield means you are getting a larger dividend for your investment. Stocks which have a higher dividend yield have better valuation in the market as compared to those with a lower yield.

Debt: Stay away from companies with high amounts of debt when looking for good stocks to buy. As most investors have found out recently, it can be very difficult for companies with large amounts of debt to survive, especially in recessionary times. The profitability of companies with overleveraged balance sheet more often than not are affected by the high interest outgo. These can have cash flow issues too. Any downgrading in credit rating resulting due to cash flow issues can have an adverse impact on stock price.

Future prospects: Understanding future prospects is important as part of financials. You can identify the factors that may influence the future performance of a stock. For instance, good monsoons should help stocks in the fertilizer sector. Future prospects of the company can be enhanced or marred by policy decision. For instance, opening up for FDI can have a positive influence in anticipation of increased capital inflows. However, factors like technology changes can have either a positive or adverse impact.

Peers: Compare your identified list of stocks against its peers in the same industry or sector. Looking at competing companies and their fundamentals can be a great way to size up a potential investment. It is advisable to invest in a market leader than the second or third rung stocks. Peer comparison is required as the same will help in relative valuation of the stock. Price earnings ratio is usually used for comparing the valuation of a company with its peers.

Strong brand: Companies with strong brands are likely to perform better in the long run even if they may be less profit making in the short run. Market puts a value to the brands too while valuing a company with strong brands.

Advantages of Investing in Equity Investments for Beginners:

- Equity is one of the best financial instruments that can offer returns to help investors beat inflation.
- If the prices of stocks increase, investors will be able to see it as an appreciation in their capital. A substantial amount of wealth can be accumulated by investors over the long-term through investments in equity funds.
- Having a diversified portfolio means investing in multiple asset classes like equity, debt; gold, etc investors have variety of choices to invest in equities.

Key financial ratios investors must look at before making investment:

- **Price-to-Earnings Ratio:**

The price-to-earning ratio (P/E ratio) is a metric that helps investors determine the market value of a stock compared to the company's earnings. In short, the P/E ratio shows what the market is willing to pay today for a stock based on its past or future earnings.

The P/E ratio is important because it provides a measuring stick for comparing whether a stock is overvalued and undervalued. A high P/E ratio could mean that a stock's price is expensive relative to earnings and possibly overvalued. Conversely, a low P/E ratio might indicate that the current stock price is cheap relative to earnings.

- **Earning Yield Ratio:**

Earnings yield refers to the earnings per share in a financial period, divided by the current share price. It is the reciprocal of the P/E ratio. The earnings yield helps investors know how much he has earned per share. e earnings yield helps the investors compare and make investment decisions across not just stocks, but other fixed investment options as well. It helps investors know whether their shares are undervalued or overvalued depending on the percentage of the yield when compared to other companies in the same sector.

- **Debt to Equity Ratio:**

The ratio is used to evaluate a company's financial leverage. It is a measure of the degree to which a company is financing its operations through debt versus wholly-owned funds. It reflects the ability of shareholder equity to cover all outstanding debts in the event of a business downturn. This ratio comes under the type of gearing ratio.

The higher the leverage ratios, it tends to indicate a company or stock with higher risk to shareholders. Investors will often modify the D/E ratio to focus on long-term debt only because of the risk in long-term liabilities are different than for short-term debt and payables

- **Operating Profit Margin Ratio**

The operating profit margin ratio indicates how much profit a company makes after paying for variable costs of production such as wages, raw materials, etc. It is also expressed as a percentage of sales and then shows the efficiency of a company controlling the costs and expenses associated with business operations. Furthermore, it is the return achieved from standard operations and does not include unique or one time transactions.

This ratio helps investors understand how a business makes money; if it is generating income primarily from core operations, or other means, such as investments.

- **EV/EBITDA ratio**

The EV/EBITDA ratio is a comparison of enterprise value and earnings before interest, taxes, depreciation and amortization. This is a very commonly used metric for estimating the business valuations. It compares the value of a company, inclusive of debt and other liabilities, to the actual cash earnings exclusive of the non-cash expenses.

This ratio is also known as "enterprise multiple" and "EBITDA multiple". The enterprise multiple can be used compare the value of one company to the value of another company within the same industry.

Steps for Beginners to start up investing in Equity Investments:

1. **Open Demat Account and password:** Demat Account is an account that is used to hold shares and securities in electronic format. The purpose of opening a Demat account is to hold shares that have been bought or dematerialised (converted from physical to electronic shares), thus making share trading easy.

   Once the account is opened, the broker will provide you with your login ID and password. The password is usually sent to residential address and may take a day or two. Some brokerages also use new technologies to constantly update the password.

2. **Track your account activity:** Your broker will send you alerts every time an order is placed and when it is executed. The broker will also send you a day-end statement of all your trades.

3. **Follow the market:** If you are a long-term investor, there is no need get worried with the daily swings of the stock. But do keep tracking developments around the stock and enter or exit a stock without any inhibition may you find a trigger that can lead to major change in price

4. **Build a diverse portfolio:** Finally, once you have picked the basic skill sets, try to build a robust portfolio of stocks with exposure across sectors and market-caps to ensure proper asset allocation in order to reduce risks.

Tips for Beginners to start up investing:

8 MUST KNOW TIPS FOR EVERY STOCK MARKET BEGINNER!

1. Start Small

2. Diversify your portfolio

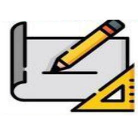
3. Invest in blue-chip stocks

4. Never invest in 'FREE' Tips/Advice

5. Avoid blindly following the crowd

6. Invest in what you know and understand

7. Invest regularly & continuously



8. Have discipline & follow your plan/strategy

Stock market terms for beginners to know before investing:

Bull market: When stock prices in a market are generally rising, it is called a bull market.

Bear market: The exact opposite of a bull market is a bear market – when the stock prices in the market are generally falling it is called a bear market.

Order: It is a show of intent to buy or sell shares in a given price range. For example, you may place an order to buy up to 100 shares of Company A, at a maximum price of Rs. 80 per share.

Ask: Ask is the price at which you are willing to sell a share.

Bid-ask spread: This is the difference between the amount people are willing to spend to buy a share and the amount at which the shareholders are willing to sell a share. A trade can only happen when this spread is resolved. That is, if the lowest price at which a share for Company A is being sold is Rs. 40, and the highest price someone is willing to pay for such a share is Rs. 38 – no trade can happen. The trade can only happen when the bid and ask prices match.

Market order: An order to sell/buy shares at the market price is called a market order. It is advisable to avoid placing market order as the trade price can be very volatile.

Limit order: An order to sell shares above a set price or buy shares below a set price is called a limit order. You should always use limit orders to trade shares.

Day order: An order that is good only till the end of the trading day is called a "day order". If the order does not get executed by the time the market closes, it would be cancelled.

Good-till-cancelled order: An order that will stay open until it is either executed or manually cancelled. Such orders may stand for weeks if no shares are available to trade in the price range specified. For example, if you place a GTC order to buy a share of Company A for Rs. 50 or less and the share is currently trading at Rs. 70. If it takes the share to hit Rs. 50 price point a week later, the order will be executed then. If it were a day order, it would have been cancelled ..

Trading volume: The number of shares being traded on a given day is called trading volumes.

IPO/Initial Public Offering: The first time a company offers its share for trading on a stock exchange. Typically, you buy shares from the previous owner of the share and not the company directly. In case of an IPO, you get to buy the shares directly from the company.

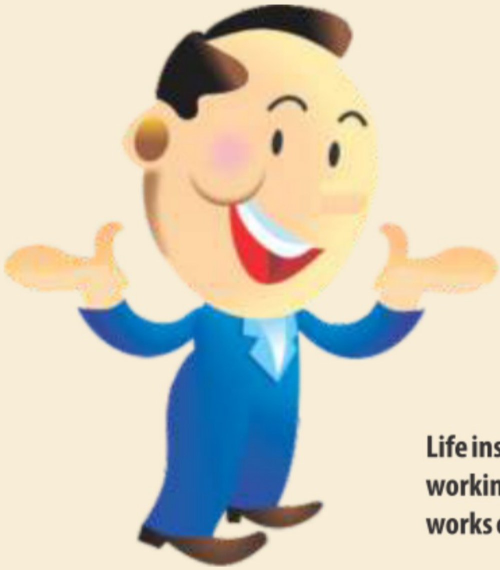
Market capitalisation: Market capitalisation is simply the value of the company as per the stock market. That is, the current value of all its shares put together.

Index: A benchmark that is used by investors and portfolio managers to measure market performance. Nifty and Sensex are such benchmarks. If your portfolio returned 10%, that may sound really good. But if the Sensex returned 12% during the same period – your portfolio did not perform very well.

Portfolio: Portfolio is simply the collection of all the investments an investor has made.

Intra-day trading: Intraday trading is about buying and selling stocks on the same day so that all positions are closed before trading hours are over on that day.

Note: This list is not exhaustive. There are many more terms that you will come across as you invest in the share market.



Life Insurance Products Do's & Don'ts

Life insurance is a Risk Cover product you need for most part of your working life. If you are considering it as an investment product, it works only if held for a long term because of its embedded costs.

Do's

- ☑ Ask policy brochure and read it carefully.
- ☑ Check in case of high returns and low risk products.
- ☑ Decide the policy on own – Be a decision maker.
- ☑ Look into purchasing a longer-term policy.
- ☑ Make sure the Agent, Broker or the Company is Licensed by IRDA.
- ☑ Accept standard illustration of the plan chosen to buy.
- ☑ Fill-up the forms completely and accurately.
- ☑ Provide all medical details.
- ☑ As a record, keep a copy of the completely filled and signed Proposal Form.
- ☑ Always pay by cheque, so that you can have record of your payment.
- ☑ Review your coverage periodically.
- ☑ Know the procedure for appeal (in case it arises in future).

Don'ts

- ☒ Invest in short-term savings product.
- ☒ Accept insurance bundled with other financial products (Insurance is not a by-product).
- ☒ Accept handwritten calculation for Life Insurance product
- ☒ Sign without reading the Terms and Conditions.
- ☒ Ignore medical details in the Form.
- ☒ Go by words of Agents or Companies in case of choosing a Policy (attractive and unrealistic offerings).
- ☒ Let Agent to fill the Form.
- ☒ Leave any column blank in the Proposal Form.
- ☒ Conceal or misstate any facts.
- ☒ Give up when individual rights are being violated.
- ☒ Accept unrealistic rewards offered by Agents.
- ☒ Purchase a policy unless you understand the concept behind it.
- ☒ Treat insurance as a tool for saving Tax
- ☒ Make any payments to Agent by Cash
- ☒ Delay your Premium payment.

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About IFE Academy

IFE Academy was established in 2011 as a Not-for-Profit entity to promote Financial Education. IFE Academy conducts Investor Awareness Programs across the country with the support of other market participants. www.ifea.in is a comprehensive website on Financial Education. It has various sections such as Videos, Puzzles & Games, Financial Calculators and Library. It gives a holistic view on financial education combining various aspects such as Savings, Investments, Credit, Insurance and Pension at a single place. IFE Academy periodically publishes Investor Educational materials and distributes it to general public.

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