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THE ECONOMIC TIMES

Build a core portfolio, but get rid of duds

Ensuring a core equity portfolio is important to keep you hedged against slump. Nikhil Walavalkar offers some dos and don'ts to build a healthy portfolio

CAN you manage a conglomerate of 50 different businesses all dealing in diverse products and services? If not, then why would you own an equity portfolio comprising a large number of stocks? After all, an investor cannot afford to forget that stocks represent businesses. Each time one buys 100 shares of a company in search of the next Reliance or the next HDFC on some tip, it might not be the best thing to do.

SMALL IS SMART

"Your ability to track and your need for diversification across sectors along with your risk appetite should decide the number of holdings in your portfolio," says AN Sridhar, fund manager, Sahara Mutual Fund. An average investor can monitor 15-20 holdings in his portfolio. The problem starts when the markets swing into one extreme and investors typically react to the extremes by displaying either greed or fear. "In good times, they own too many stocks and in bad markets they own too few resulting in lack of monitoring or lack of diversification, respectively," says Sridhar. Striking the right balance holds the key to wealth generation.

CORE TO THE FORE

A seasoned investor would always have a core portfolio. A core portfolio is for the keeps and shares in this portfolio are rarely traded. Exits are rare and made only after fading of the underlying value proposition that makes them tick is ascertained. Rather, investors prefer to keep adding their positions in such stocks in a weak market. These holdings primarily include blue-chip ones with a long-term performance track record or large-cap equity mutual funds. Of course, you can have some allocation for 'flavour of the season' if you are comfortable with momentum investing. But in no case such momentum calls should outweigh the core holdings.

WEIGHTAGES

"Under no circumstances, should you invest more than 20% of your equity investments in one stock, even if your personal stock portfolio has merely 10 stocks," advises Gopal Agarwal, deputy CIO and Head-Equity, Mirae Asset Global Investments (India). Too much exposure to one stock can hamper portfolio returns if things go bad with that company in which you have invested heavily. At the same time, there is no sense in investing if you are not giving due weightage to a stock. "In my personal portfolio, I do not invest in a stock if I cannot commit at least 4% of my investible money to it," says a money manager with a wealth management set-up. Take a simple example. You spot a 10 bagger stock and invested only 0.01% of your money in it. A 10-fold rise even in a short span of time will not have material impact on your portfolio. You have to make it a 'meaningful' investment.

KEEP IT SHORT & SIMPLE

BUILD YOUR CIRCLE OF COMPETENCE

- **If you are** a medical practitioner, probably you have a core understanding of healthcare and pharmaceutical business. Identifying good companies there and buying into them at lower levels can be a good strategy. One can also look at something that we come across in day-to-day life such as consumer goods. Goods and services preferred by most may develop the pricing power and become a good investment in the long run.

STICKING WITH PROVEN WINNERS

- **Spotting the** next Infosys is probably the biggest value accretive proposition with the highest degree of risk. But most of us tend to forget that Infosys Technologies is a success in its business and risk of failure is low. Your risk profile should decide whether you want to search for tomorrow's winners or you intend to stick with today's winners.

WEED OUT THE LOSERS

- **Twenty five years** ago, Ballarpur Industries, Century Spinning, Bombay Dyeing, Great Eastern Shipping, Siemens, Peico Electronics (Philips), Kirloskar Cummins, Premier Automobiles, Hindustan Motors, Ceat Tyres and Voltas were considered to be blue chip companies. Though blue chips do not fall out of favour overnight, over years there comes an inflection point in the life of a company when its shares start lagging. While you must have a core portfolio, it is important to identify the laggards every few years

INDIRECT EXPOSURE

Note that your exposure to a company is what you have invested in it and your mutual fund's contribution. For example, you have Rs 10-lakh investment in a mutual fund scheme that has 5% of its money in Reliance Industries and additionally, out of your Rs 2-lakh equity portfolio you have invested Rs 40,000 in Reliance industries. Here, your exposure to Reliance Industries is Rs 90,000 or 7.5%. Some investors do not invest in stocks where their mutual fund investments have an exposure. Simple reasoning behind avoiding such stocks is the fund manager knows how much to invest in that stock. Why add to that position if you do not have more information about that stock than the fund manager? Such investors allocate their direct equity investments in stocks that do not appear in mutual fund managers' universe.

SPECIAL SITUATIONS

With rising corporate actions such as buybacks, open offers and asset sale, investors have started following special situation investing. "Quantifiable risk and limited returns is peculiar to special situations and one should invest in such opportunities only after taking into account investment opportunities otherwise available. But in no case one should sell core portfolio holdings where one may see good upside in the long term," advises Chetan Parekh, director, Jeetay Investments. Some investors prefer to restrict their exposure in such special situations to 10% of their money in equities.

WEEDING OUT AND BOOKING PROFIT

A stock that you bought in December 2007 at, say Rs 100, went down in 2008 to Rs 10. Should you get out of that stock at Rs 30 now? The answer is very simple. If you have not bought the same stock at any price lower than Rs 100 nor you intend to buy it at Rs 30, better get rid of that stock. It does not deserve a place in your portfolio. Identifying investment mistake is very important. Wrong investments erode the capital. On the top of that, if you still hold on to them, you lose out on the opportunity of investing in some good quality stocks. This, in turn, pulls down portfolio returns.

In equity investing, realising paper profits are important. There were many who in early 2007 did not sell their stocks and booked profits only to see the paper profits turning into paper losses. Managing an equity portfolio is a tightrope walk. You will be better with it if you identify your circle of competence and stick to it.

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