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Five General Wrong Methods of Investment and Its Suggested Solutions

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Abstract -- This paper is based on '*Qualitative'* and little bit '*Technical*' Research. In which researchers explain five wrong methods of investment in general which are generally adopted by new investors to invest money in various sectors. The researchers have tried to provide the suitable solution of these wrong methods of investment on the basis of few live cases along with general suggestions which are based on their personal experiences during the time of investment in various segments of capital markets and physical investment in other assets.

Index Term*:* Investments, Solutions and Wrong Method;

1. Introduction

The word investment has a meaning of putting or sacrificing money for return or profit or we can say a materialistic result which increases the wealth of the investor. As far as researchers' personal experience concerns, investment is that phenomena which results in wealth maximization or profit and it also tries to maintain the time value of money up to a certain level due to appreciation or value addition. On the basis of our understanding and personal experience, we always ask one question to our respondents (students who are in their master degree in finance or other people) who directly or indirectly become the member of portfolio investment to invest his or her saving to stock markets in India or abroad. The question is that: 'Why do people go for Investment?' and in response of this question, people or students give different type of answers such as 'Investment is done to generate profit' and we received other similar type of answers but on the basis of personal observations, it can be said that people go for investment because they want to earn money without any physical work and they also try to get profit or return more than fix rate on debt securities such as debentures, bonds, bank deposits etc. Though our personal experience which we got from our poor investment strategies, we learnt investment technique that there is no perfect method to forecast the stock price of any stock. We see various live examples in our surroundings where people generate 20 to 30 percent profit within a minute or a day but if we see the other side of this profit, the stock market is all about 'zero sum game', it means when someone gets losses then someone generates profit. According to the personal experience of various experts, they always say if you want to learn investment process you should have to do real investment in stock market. Because the investment amount is also your own and due to this reason, investor takes more precaution in investment strategies and that is one of the most crucial and true fact which have a great impact on investment strategies. It is a very beautiful quotation in context of investment, 'If you want to learn swimming, you must have to Jump in water and the result is whatever?' On the basis of the title of this paper, the first author has to share his personal experience related to the investment techniques which he learnt from investment losses. These five wrong methods of investment will also help other investors who are new and trying to invest his or her saving in capital market.

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2. First Wrong Method of Investment

As per the experience of the first author, it is recommended not to invest small amount of money such as Rs. 5000, Rs.10000 or up to 30000 in stock market because the volume of this amount is so small and investor would not be able to purchase different variety of share so due to this reason his /her portfolio risk would be too high. If someone has small amount of capital to invest, it is always better that he /she should have opt the facility of 'Mutual Funds' because in Mutual Funds, portfolio risk is 100 times lower than direct investment. For more understanding see live example.

2.1 Example of Live Case

Capital Amount invested Rs. 20,000/- in Indian Capital Market (Specially in BSE

Table 1.1
Investor Portfolio

S.No.	Name of Company	Share Price as on 25th October 2013 at 10:00 am (Rs)	No. of share Purchase	Amount Rs in BSE
01	Bajaj Auto Ltd.	2082.60	2	4165.2
02	DR. Reddy's laboratory Ltd.	2391.40	2	4782.8
03	Hero Motocop Ltd	2079.35	2	4158.7
04	HDFC Bank Ltd.	608.40	5	3042.0
05	ITC Ltd	342.55	6	2055.3
06	Maruti Suzuki India Ltd	1515.45	1	1515.45
Total				**19719.45**

In this portfolio, investor takes the share of six companies only which are listed in BSE. There may be another possibility that investor may also select other companies whose values of shares are very less but problem is that when you go for S&P 500, the risk factor would also increase because the performance of the share is directly or indirectly depends on the market capitalization. The strength of market capitalization shows the trust of people on sector or company. That is why in this case, investor only selects those companies which are among top 30, whose names are shown in Sensex.

When we calculate the continuous compounded rate of returns of the above mention companies

Formula of Continuously Compounded rate of returns

$$= \sigma\left[\sum_{i=1}^{n} \mathrm{Ln}\left(\frac{P_i}{P_{i-1}}\right)\right]$$

Where:

P_i = Current price of Stock; and

P_{i-1} =Previous price of stock

σ = Standard Deviation

Investor traded with the amount of Rs. 20000/- for a day, for a week and for a month;

Return Calculation Table 1.2
When Investor trade only one time in a day in a week and in a month

S. No	Name of Company	Amount Allocated (Rs.)	Return and profit on one day		Return and profit on one week		Return and Profit on one Month	
			Return (%)	Profit (Rs.)	Return (%)	Profit (Rs.)	Return (%)	Profit (Rs.)
01	Bajaj Auto Ltd.	4165.2	0.035	1.45782	0.266	11.07943	1.064	44.31773
02	DR. Reddy's laboratory Ltd.	4782.8	0.051	2.439228	0.374	17.88767	1.499	71.69417
03	Hero Motocop Ltd	4158.7	0.061	2.536807	0.452	18.79732	1.808	75.1893
04	HDFC Bank Ltd.	3042.0	0.053	1.61226	0.394	11.98548	1.577	47.97234
05	ITC Ltd	2055.3	0.391	8.036223	2.934	60.3025	11.73	241.0867
06	Maruti Suzuki India Ltd	1515.45	0.087	1.318442	0.659	9.986816	2.637	39.96242
	Total	19719.45	0.678	17.40078	5.079	130.0392	20.315	520.2226

If investor trades one time in a day with this portfolio so most probably he or she will be able to generate only Rs. 17 to Rs. 50 per day profit. Similarly if he / she trades one time in a week so he or she will be able to generate approximately Rs. 130 to Rs.400 per week and in case of month he or she will be able to generate approximately Rs. 500 to Rs. 1000 per month. (For understanding see table 1.2)

2.2 Actual profit on above portfolio

On the basis of above portfolio, you can easily understand that the amount of investment is really too small, so it is very difficult to generate good amount of profit from that amount. If we consider the cost of transaction (direct and indirect), which includes the charges of sale and purchase of the shares which are called brokerage charges and other minor charges such as internet uses charges and system maintenance charges, it will reach to the level of two to three percent in terms of return. Due to that reason, the

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actual profit becomes less than the amount of given output or it may come in negative also. (For more understanding see figure 1.1)

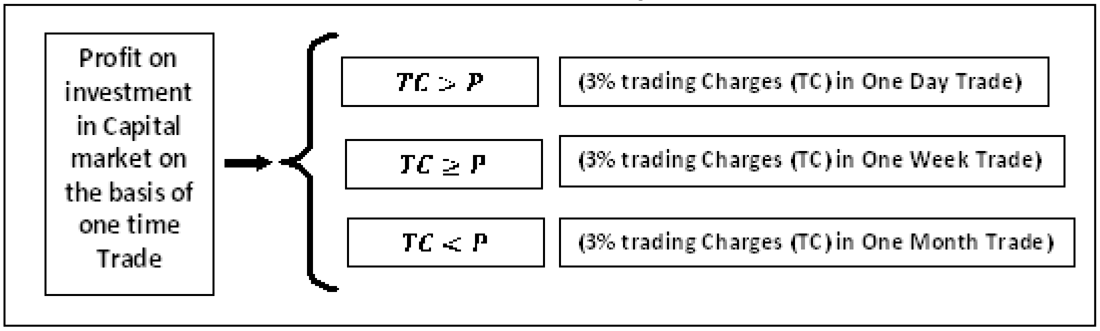
$$\text{Trading Charges} = Rs.19719 \times \left(\frac{3}{100}\right) = Rs.591.57\%$$

(Approximately)

Where TC = Trading Charges; and
P = Profit

Compare this Transaction Cost (TC) with profit (P) because if a person trades single time than transaction cost will be same in all three cases of table1.2. In these live cases, once in a day or once in a week trading shows losses instead of profit due to transaction cost and once in a month trading gives profit only. (See figure 1.1)

Figure 1.1
Comparison of Transaction Cost with Profit on Once in a day, once in a week and once in a month trading



Loss on once in a day trading $= Maximum(\text{TC}) - \text{Maximum(P)} = -\text{Rs.}541.57$ loss
Loss on once in a week trading $= Maximum(\text{TC}) - \text{Maximum(P)} = -\text{Rs.}141.57$ loss
Profit on once in a month trading $= Maximum(\text{TC}) - \text{Maximum(P)} = +\text{Rs.}408.43$ Profit

2.3 Solution of First Wrong Method of Investment

In the above live case, we only suggest one solution that the investor should trade multiple times in a day from 10:00 am to 4:00 pm and it can be called per minute trading. If investor trades after every five minute in day, he or she trades 12 times in an hour. It means that he or she would trade $(12 \times 6 = 72)$ 72 times in a day. On the basis of this result, investor can generate good amount of profit on the basis of given series

Profit (P) =
$Rs.17.4 + Rs.17.4(+ROPP) + Rs.17.4(+ROPP) \ldots\ldots\ldots\ldots(72\ time) = Rs.1252.8 + \sum_{i=0}^{n-1}(ROPP)$

$$\text{Approximate Profit (P)} = Rs.1252.8 + Rs.85.67 = Rs.1338.47 \text{ per day}$$

Where
ROPP = Return on previous profit;
$n = 72 - 1 = 71$; (start from 0 to 71)
This ROPP would be added in the profit only when the investor invests previously generated profit in the next trading during square-up and number of trading may increase or decrees on the basis of the investor's performance in the given period of time.

The Formula to Calculate Profit on Multiple Trading would be-

$$Profit\ on\ Multiple\ Trading = (AA_{Profit}) \times (NOTTPD)] + \sum_{i=0}^{n}(ROPP)$$

Where:
$AA_{profit} = Average\ Approximate\ profit$; and
$NOTTPD = Number\ of\ Trading\ Time\ Per\ Day$;

Profit per week on the basis of Multiple Trading $= Rs.6264 + Rs.475.72 = Rs.6{,}739.72$; and
Profit per month on the basis of Multiple Trading $= Rs.25056 + Rs.2034.56 = Rs.27{,}090.56$

Profit of Rs. 27,000/- approximately is really a handsome amount in a month, which was generated by the investor from the investment of Rs. 20,000/- in capital market. As far as profit concerns, this amount is not a good amount of profit. If investor does job in any organization then he or she would be able to get at least Rs. 20,000/- to Rs.25, 000/- as a salary per month easily without any risk factor. Now the exact profit would be Rs. 2,000/-[Rs. 27,000- Rs. 25,000/-] and this is not a good amount of profit with high level of risk.

3. Second Wrong Method of Investment

This wrong method is related to those people who have inadequate amount of knowledge about the stock market or in other words we called '*zigzag*' knowledge of stock market. With this kind of temperament, investor feels that he or she is perfect in stock market investment strategies and this type of investors also try to give advices to other people to invest in xyz companies' share. Most of the time, their luck depends upon the probability of risk factors, some time their advice works wonder and some time it does not work. The scope and role of a financial advisor is like a doctor and he or she advices his / her client to invest in particular sector or in a company so in result of that if investor got profit then his or her belief on financial advisor will increase and because of that the market value of financial advisor also will increase simultaneously same as doctor. So it is always recommended to track the performance of the financial advisor on the basis of his or her market performance based on clients' feedback. Some time new financial advisors come in market after completion of their graduation and master degree in finance and they feel as perfect in portfolio management but reality is not that because there is no perfect method or process to trace the actual performance of the stock exchange. There are so many cases in historical data of Indian stock market in which it may be seen that the advices of various senior financial analyst and experts were unable to trace the trend of Indian stock market at the time of January 2008 in which Sensex had reached at the level of 8000 points from 21000 points.

3.1 Solution of Second Wrong Method of Investment

In this wrong method of investment, we would like to suggest that the investor should invest in capital market on the basis of primary research done by yourself, if investors are educated and good enough to read and write with having capability and ability to use internet then it would become more effective, efficient and fruitful for formulating and implementing investment strategies. Try one thing especially before investing in capital market, read stock market performance based on Nifty and Sensex and their listed companies up to one to three months and check the prices (opening and closing) of these 50 and 30 companies on intraday basis with the help of internet or newspapers such as Economics Times, Financial Express etc. In result of that you may easily understand and trace company or sector which is performing or may perform with better prospects in given period of time. This technique works for those people who do not have adequate knowledge of finance and financial statements and if anyone belongs to finance background and aware about it then he / she obviously will do more work according to his /her theoretical knowledge which has been received or gained from class teachers and self learning through books, newspaper etc.

In India most of the investors or traders are not educated so all those works which we mentioned in above solution are not useful for such kind of people. For such types of investors, we advise them to take the help of financial planner who will invest their money in proper manner to secure the fund against the risk and to generate good amount of profit on it. While proving this service investors have to give fees to financial expert or share profit on the basis of given agreement.

4. Third Wrong Method of Investment

It is all about young investors who want to make money quickly with high enthusiasm and as far as experience concerns, they are novice to that field i.e. least experienced for investment. In most of the cases, young investors invest money in small companies and the result is that the possibility of losses is 80 percent higher than large scale companies. As per live cases if 100 new young investors invest money in small scale industry then only 20 investors get high rate of profit which is 100 to 200 percent of the principal amount invested and remaining 80 investors get loss up to 50 to 70 percent. If you are experienced than you may analyse which small Scale Company will perform better in future though this experiences will be gained in long time. The investments in small scale companies are only useful for experienced investors because they know the pulse of stock market perfectly and also know the nature of the companies and its product on basis of their life cycle.

4.1 Solution of third wrong method of investment

According to our knowledge and experience, the young investors should have to invest in top 30 or top 50 companies in the beginning period of his or her investment experience. The risk factors in these companies are always lower than small scale and medium scale companies but as far as return is concerned, the profit output is also lower than small and medium scale companies. As per our advice, new investors should invest money in small and medium scale companies after getting self experience of at least two to three years in investment with their own capital in Sensex and Nifty listed companies. The risk and return always work together as a law which is given in various books of finance that '*higher the risk higher the return 'or lower the risk lower the return*, and this law is universally accepted with few limitations that *'clever, smart and experienced people have power to run fast without failure'*. It means that experienced investors have an ability to invest money in small scale companies and also able to generate good amount of return with minimum risk.

5. Fourth wrong method of investment

Please don't invest your money in physical assets such as land, flat, shop or any other property. This type of investment block your capital for a long period with lesser liquidity but if we talk about return, this type of investment gives no return on regular basis but profit is in the form value appreciation which may be four or five times of invested capital and off course better than any other investment in capital market. The physical investment is good for those people who have surplus amount of capital as savings which would not be used or required up to one, two or three years. In such kind of investment if investor requires money urgently, he or she can't be able to get a client who would pay according to the market value of the property. There are so many live cases seen in surroundings where people are not able to receive the market value of the property in general when they need money but not received due to liquidity problem.

5.1 Solution of fourth wrong method of investment

As per our knowledge and experience, only such investors goes for long term investment in physical assets who have surplus amount of money which is lying as idle and that is not required or not in use at present and it would not be used in any emergency. The investor prepares backup in advance for emergency but not able to sale physical assets in emergency cases in such investments. So most probably, he or she will not be able to receive the price according to the current market value of the property. According to our experience, the investment in property will require time to sale property up to the market value.

6. Fifth wrong method of investment

This wrong method is related to those people who invest money in Gold Jewellery. In such type of investment, investors loose 20 to 30 percent value of investment at the time of purchase because gold jewellery investment includes 20 to 30 percent manufacturing cost. In future if investors sell gold jewellery then he or she would receive 20 to 30 percent reduced value in investment and get remaining value of gold according to the current market price. See live example:

If an investor purchases gold jewellery of Rs. 1, 37,059.78 and in most of the cases gold jewellery is made of 22 Carat Gold. As on 30th March 2014 the cost of 10 gram 22 Carat Gold is Rs. 26357.65/-. In this case if investor purchases 40 grams of gold then he or she has to pay Rs. 1, 05430.6/- $[(26357.65 \times 4) = Rs. 105430.6]$ plus jewellery manufacturing cost Rs. 31,629.18/-. Then the total cost of gold and manufacturing would become Rs. 1, 37,059.78/-. In future if investor sells this jewellery then he or she will only receive the price of 22 Carat gold according to the market price after deducting manufacturing cost of jewellery.

In another case, if investors purchase Gold Brick instead of jewellery then he or she will not be liable to pay manufacturing cost. This process of investment is different from investment in jewellery. In this case if you purchase Gold Brick from registered shop then at the time of purchase you have to pay five percent tax and three percent tax at the time of sale of Gold Brick. So the total amount of loss approximately in the form of tax becomes eight percent which may increase or decrease according to the market value of gold. See live example

If investors purchase Gold Brick of 50 gram on 19th September 2010, at that time 10 gram 24 Carat gold was costing Rs.19,215.10/-. So total amount invested at that time became Rs.96075.50/- Plus 5% tax and final bill payable at the time of purchase of 50 gram 24 Carat Gold Brick became Rs. 1,00879.28/-, which includes Rs. 4,803.775/- as of tax. If same investor sells this Gold Brick on 30th March 2014 and at that time, the market value of 10 grams 24 Carat gold became Rs. 28,190/- so the cost of 50 grams 24 Carat Gold Brick would become Rs. 1,40,950/ and he or she would pay 3% tax at the time of sale of Rs. 4,228.50. In this type of investment, investor generates profit of Rs. 35,842.22/- $[(Rs. 140950 - Rs. 100879.28 - 4228.5) = Rs. 35842.22]$. If investor does not paid sale and purchase tax on gold so he or she will able to generate profit of Rs. 44,874.5/-, which is more with Rs. 9,032.38/- then tax paid profit.

6.1 Solution of fifth wrong method of investment

The solution of this wrong method is related to non ethical process which we call parallel market strategy. In this process people do trade in such a manner in which he or she does not want to pay tax. All the transactions take place in an illegal form on the basis of the goodwill of the person. In it, investor invests money in Gold Bricks through unorganised traders with the help of local gold traders or in Hindi we call it '*Sunar'*. In such kind of transactions, investor does not pay any tax at the time of sale or purchase of Gold Bricks. We know that the solution given for this wrong method of investment is not ethical but as per our knowledge, this type of transactions is always activated in such kind of market where people invest money in physical gold.

7. Discussion

This paper is divided into five parts. The each part of it highlights one wrong method of investment and also suggests its solution through suitable example or directions. The first wrong method of investment is related to small amount of investment. In this section researchers discussed one live example along with most probable suitable solution. The second wrong method of investment is related to those people who are influenced by other investors, and do not have sufficient amount of knowledge related to stock market and shows that they are highly trained and skilled in this sector. In this section researchers also provided suitable dimensions, how to handle such kind of problems which were created by other investors. The third wrong method of investment is related to those people who are energetic in nature in terms of investment and invest money in small scale companies and the result is that they generate losses instead of profit. In these section researchers also provided strategist view related to the investment process in terms of experienced persons who invest money in small scale companies as a solution. The fourth wrong method of investment is related to the pros and cons of property investment and also suggests direction, what kind of investor invests money in this sector. The fifth wrong method of investment is related to the Gold Jewellery and Gold Brick. In this section researches discussed about the negative features of physical gold investment in terms of manufacturing cost and taxes and also highlighted some unethical and illegal practices in respect of gold bricks investment. These wrong methods of investment are related to general people who do such kind of basic mistakes at the time of investment. More future research will be required in this sector in term of behaviour pattern of investor.

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[1] This paper does not require any references because it was based on the personal experience of our investment in general cases which we mention as wrong method of investment. Only few references were take pale in respect of return calculation in first wrong method of investment.

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