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Management of Volatility in Stock Market of India

KEYWORDS Stock market, volatility, cross over, Cash Cow Company.

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ABSTRACT *Investment is a crucial decision for the common people. The dividend from shares of domestic Companies is tax-free whereas the interest on Post office and Bank deposits are taxable. Even the Government of India has taken decision to invest monies of Employees Provident Fund in the capital market. Unfortunately most of the people in our country are financially illiterate. Stock market is always volatile and one must know to cross over such volatility. It is true that investment in equities can give higher return than to invest in Gold, Silver and Copper or in Commodity market. But selection of the stock to invest is most important so that capital may remain intact, if not more. Some cash cow companies pay huge dividends along with good growth. This paper is an attempt to find out the strategies to cross over the volatilities in stock market.*

Introduction
In stock market some days are good and some days are not and always expect the unexpected. The Government of India indirectly insists the common people to invest in stock market by keeping the dividend income from Indian companies tax free. But the ordinary Indians are not financially so much literate that they can take their own decisions due to the volatility of the stock prices in the market. Few strategies can be adopted to cross over the volatility of stock prices to arrest the capital erosion and there may be growth of the share prices as well.

Objectives of the Study
The objectives of the study are:
1. To understand the meaning of volatility of Stock market and how to reduce risk of a stock;

2. To find out the strategies to cross over such volatility;

3. To protect the capital of the investor and its growth at the same time.

Methodology of the Study
Primarily the day to day knowledge of the market has been used and the secondary data have been used as and when it has been required. A diary was maintained since 2006 to record various data and facts of the market which has come in to a great use.

Meaning of Volatility
Volatility means the price fluctuations of shares in the market. The volatility is measured by the technique of dispersion of statistical method. Generally high standard deviation indicates high volatility and vice-versa. The risk of an individual security is measured by the variance or standard deviation of its return. The risk of the portfolio also is measured by the same technique i.e. by calculating the variance or standard deviation of its return. Higher the volatility, the riskier is the security. One measure of the relative volatility of a particular stock to the market is its beta.

Diversification of stock and total risk
Total risk of a stock = unique risk of the stock (unsystematic risk) + market risk (systematic risk) The unique risk of a stock can be reduced by combining it with other stocks. In a diversified portfolio, unique risks of different stocks tend to cancel each other and vice versa. There is a thumb rule in the market that '*Don't put all of your eggs in one basket*'. Unique risk is also known as **diversifiable risk or unsystematic risk.**

On the other hand, market risk is attributable to the economy-wide factors and these factors affect all firms to a greater or lesser degree. So investors cannot avoid such risk whatsoever diversified their portfolios may be. Such risk is referred to **as systematic risk or non-diversifiable risk.**

Cross over of volatility
The market risk cannot be reduced as it is spread over the whole economy. But one can reduce its total risk by controlling unique risk (unsystematic risk) by proper diversification of stocks. For plummeting total risk and for capital appreciation as well the following strategies are suggested:
I: Focus on dividend yields than price appreciation

II: Focus on high dividend yield plus growth

III: Buy stocks in small lots only

IV: Buy 'fallen angels' that have dipped 20 to 30 times in terms of PE

V: Never invest in stock trading high on thin volumes

VI: For expert investors: Buy 'put', if you feel shares would fall further

VII: Do not over-rely on historical beta, valuation and past performances

VIII: Avoid scripts that are dependent on markets for momentum

IX: Use derivatives for hedging purposes

X: Do not indulge in double leveraging

XI: Don't invest money on 'hearsay'

XII: Don't lose track of your money

The last strategy is 'Buy at low and sell at high.'

Identification of Shares
The help of technical analysis is by and large taken for understanding the prospect of a share for a very short period

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and such analysis is essential by the traders but not the investors. For building a long term portfolio fundamental analysis is essential. The following ratios are imperative to analyze before making investment in capital market:

1. Dividend Pay-out Ratio(D/P Ratio)
Dividend per Share (DPS) / Earnings per Share (EPS)
From close introspection of the Financial Statements and Balance Sheet of a company the amount of net profit and reserves can be known.Net profit is used in two ways viz. either by distribution of dividend among the shareholders in cash or by ploughing back of profits by means of Reserves. So by judging the Dividend Pay-out ratio it can be understood. If a lesser part of net profit is given as dividend, it means the other part is retained by the company for its future growth which in turn helps to appreciate the value of the share of the company. Thus capital appreciation can be possible.

Thumb rule: If there is Reserves in the Balance Sheet double than its issued capital, that company has a chance of issue of bonus shares.

2. Earnings per Share (EPS)
Profit after Tax (PAT) / Total Number of Equity Shares Issued
Suppose EPS = Rs.7, Face value per share = Rs.10 and Dividend paid 20% i.e. Rs.2 per share. This means one investor in that share is getting Rs.2 per share in cash and Rs.5 is retained in the business for future growth which is called plough back of profit.

3. Book Value per Share
Shareholders Fund / Total Number of Equity Shares Issued.
With the help of this ratio one can understand that whether a share is over / under priced. The under priced shares with future growth can be our prime choice.

4. Price-earning (P/E) Ratio
Price of the share / Earnings per share (EPS)
Low P/E ratio is not always good. The higher P/E ratio indicates the confidence of the investors as in case of blue chip companies usually have high P/E ratios. But low P/E ratio would offer the most attractive investment opportunities provided the future growth prospects are good.

5. Price to Expected Growth (PEG) Ratio
PE / Forecasted Growth rate in EPS
Thumb Rule: A PEG Ratio less than 0.5 indicate a very attractive buying opportunity and if it is more than 1.5 or 2, it is the time to sell.

6. Dividend Yield Ratio
(Dividend per share / Market price per share) X 100
The average dividend yield in India usually varies around 2% of the market price of the shares.

Thumb rule: According to Warren Buffet 2% can be earned from dividend and 8% can be earned from growth in case of shares of Indian companies.

7. Return on Capital Employed (ROCE) and Return on Net Worth (RONW)
This ratio is useful to know about a company's efficiency and the quality of management which may be the most important point to invest in a share.

ROCE= Operating Profit / Capital Employed
And Operating Profit=Net profit + (Tax paid + depreciation + extraordinary onetime expenses) - (extraordinary onetime income + other income)
RONW=Net profit / Net worth

8. Debt-Equity Ratio
Long term debt / Equity + Reserves
The company which has no debt or very less debt like .02 as compared to rupee 1 net worth can be taken in to consideration for investment.

Thumb rule: Low debt or even zero debt company is more suitable company to invest.

9. Current Ratio
Current Assets / Current Liabilities
It is desirable that current assets must be more than current liabilities so that the company may have positive working capital. If current assets are more the working capital also will be more which is better for the smooth running of the business.

Thumb rule: The current assets should be double than current liabilities.

10. Liquid Ratio
Liquid Assets / Liquid Liabilities
With this ratio one can understand that whether the company is ready to meet up its liquid liabilities immediately.

Thumb rule: The liquid assets and liquid liabilities may be equal but liquid assets cannot be less than liquid liabilities.

Observations and Conclusions
In capital market patience is reworded. After proper studies and observations one can buy a share but at less quantity. Next buy should be after at least 5 to 10 percent fall in the market of the same stock. For a long term investor income visibility is more important than market news. So, fundamentally strong companies and recession prone companies may get a room in one's portfolio. The product or services of few companies are always in demand and those firms do well even in recessions.

One needs to understand the basics. In the words of Charlie Munger, 'It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent.

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