Investment lessons from the last decade

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The decade of 2000 – 2009 has been one of the best decades from investments perspective. India became an economic growth power and all the asset classes saw phenomenal growth. But the same decade also witnessed subprime crisis and IT meltdown.
As we enter the new decade, it will be interesting to pick up some investment lessons from the last decade. Our learnings are as under:

Nothing is impossible

Ten years ago it seemed unlikely that Lehman Brothers would collapse, Bank of America and AIG would need a rescue, or that oil would rise to $140 from $20, or that gold would skyrocket above Rs. 17000 / 10gm. Yet all that is a reality now.
It is fair to assume that some of the things that may happen over the next ten years seem just as unbelievable today.

Have a portfolio that doesn't keep you awake at night

For real people with real lives, investments that let you sleep at night are far more valuable than speculations that offer "action" and "excitement". Some investors took exposure in assets like real estate projects which were just on papers, private equity in companies, leveraged investment etc. All these risky investments went for a toss because of the slowdown in last couple of years.
These kinds of investment are good if you have a long term time horizon and if they form a very small part of your portfolio.

Wealth creation happens by staying invested for long

In the last 10 years, BSE Sensex has multiplied by 3.5 times, all the 36 mutual funds with a track record of more than 10 years have on an average multiplied by 5.2 times, the top 10 mutual funds have on an average multiplied by 9 times. How many people have made this kind of wealth by doing active trading and by timing the market? The answer is either nobody or very few.
Long term horizon reduces the risk of equity portfolio. The beauty of equity markets is that after the crash it rebounds very quickly, so if your investments are in red then you should not panic and stay invested for some more time for recovery to happen.

Diversification did not fail

When asset classes like Equity and Real Estate were going through the bull phase from 2003 to 2007, investors lost interest in Debt and Gold which were not very attractive then. As a result, when Equity and Real Estate crashed in 2008, investors had very little exposure in Debt and Gold which gave good return after the crash.

Diversification did not fail, our memories and our expectations failed. True diversification comes from stocks versus bonds, not stocks versus stocks.
Diversification has been sold as something that would prevent losses. That's not the truth. What diversification means is that if you divide your money between various assets, you will not have all of your money in the best assets. You are in the middle, and in the middle it doesn't mean that it's going to be always positive.

Take expert forecasts with a grain of salt.

How many experts forecasted the equity market crash of 2007 or how many predicted the recovery of 2009? Go back to Dec 2007 and try to remember the forecasts made by financial experts, most of them were saying that we are going through the golden period and that Sensex will touch 30,000 by mar'09.
Make sure that your investment plans are not made on the basis of expert forecast. Investments should be on the basis of your risk profile, time horizon and cashflows.

Rebalancing reduces risk and brings stability

Periodic rebalancing of Equity and bonds is the best way of market timing - a foolproof way to buy low and sell high. For instance, if your 70%/30% Equity/ Bond allocation has changed into a 75%/25% split because of market movements, then sell stocks and add Bonds to bring your portfolio in line.
At the time of Equity bull run between 2003 and 2007, If you would have rebalanced and booked profit from equity once a quarter, you'd have been less exposed to the market in 2008 crash. And if you'd have rebalanced and bought equity at the beginning of this year, you'd have captured most of the rebound in Equity. Rebalancing is no rocket science but it is the most crucial risk management technique.

Financial Plan is very important

Many people had concluded that since Equity and Real Estate would always go up, they didn't need to plan cash flow for their important aspirations like education and marriage of children, retirement, medical expense etc. When markets crashed, they had to sell their assets at bottom rock prices to cover the expenses.
A good financial plan would have spread investments in different asset classes as per the cash flow requirement and would have ensured that all the aspirations are being taken care without making a distress sell of the assets.

Be aware and stay in control

Nobody will take better care of your money than you. It is very important that you get educated, get empowered and informed.
Stay on top of your investment plan and ask questions to your financial advisors.