# Investment in Equity (Part 10)

Our theory is to buy when price starts rising, and to sell when price starts falling. We had also decided that we will conclude that the price has started rising, only after the price has risen 5% from the last formed bottom. Similarly, we had also decided that we will conclude that the price has started falling, only after the price has fallen 5% from the last formed high. Thus 5% will be our trigger. A 5% rise from the last formed bottom triggers us into purchase. A 5% falls from the last formed top triggers us into sale.

The logic behind the theory is this: we will buy a scrip only after it has climbed at least 5%. Conversely, we will not buy a scrip which has not climbed at least 5% from its last formed bottom. Conversely, again, we will never buy a scrip when the price is falling. This deserves reiteration: never buy a scrip when it is falling.

Similar rules have to be made applicable to selling too. We will sell a scrip only after it has fallen 5% from its last formed high. We will never sell a scrip when it is rising. This deserves reiteration: never sell a scrip when it is rising.

Buying a scrip when it is falling and selling a scrip when it is rising are the two Himalayan blunders many of those present in the stock market frequently do. They can't resist the temptation to buy a scrip when it has fallen and become cheaper than before. Similarly, they can't resist the temptation to sell a scrip when it has risen a bit and some profit has accrued. In fact, the pressure an investor feels is more when a scrip he holds is in profit.

When we have bought a scrip and are holding it, and the price is rising, we should not sell it. When a scrip, held by us, is rising, it is the ideal situation for us to continue to hold it. In fact, that is what we expect the scrip to do when we are invested in it: we expect it to go on rising. While it is rising, selling it away will be illogical. Some investors advise to sell the scrip away when you have got a reasonable profit. The terms reasonable profit might vary from investor to investor. For investor one, 10% profit may be sufficient, while investor two may be wanting not less than 20%. There can be another investor who wants twice the interest that a term deposit with a bank fetches. There may be a fourth investor who wants 100% profit.

How much profit should you take? My theory will tell you that your profits should be market-wide. Now, that is a new term, 'market-wide'. My theory of buying when price starts rising, and selling when price starts falling gives you market-wide profit.
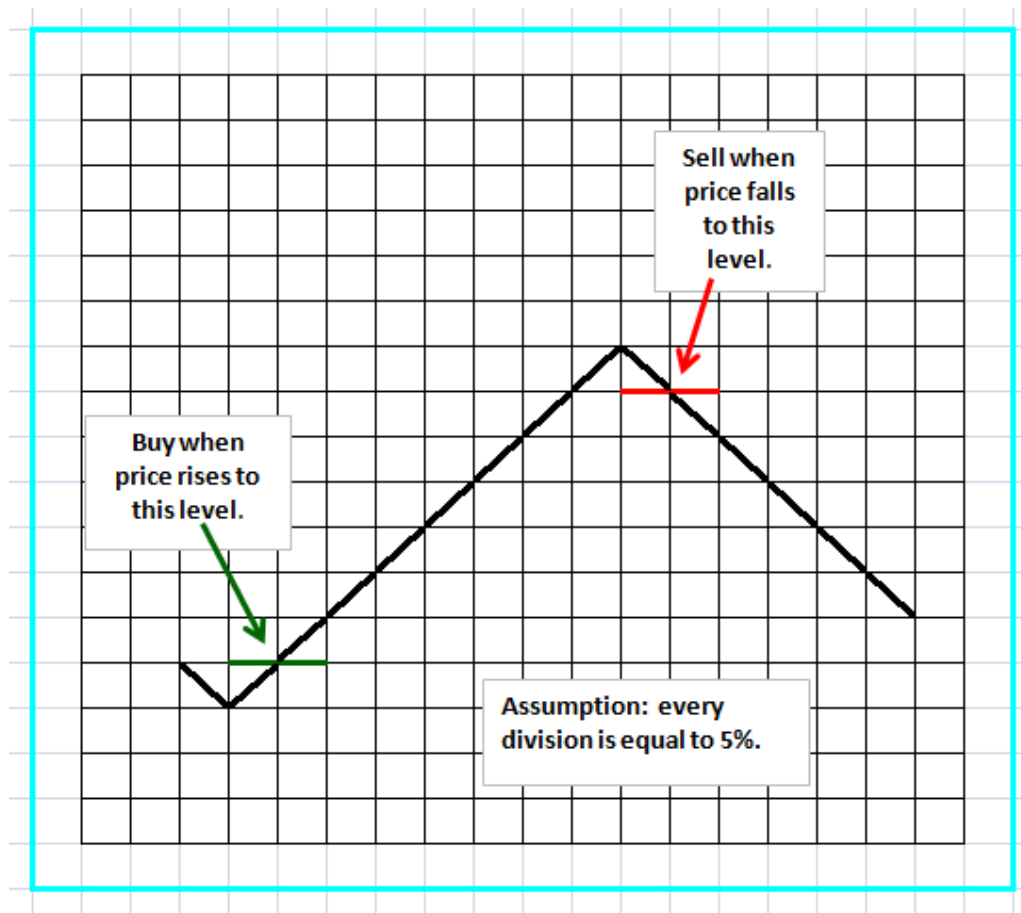
The theory is well illustrated by the above given short graph. Assume that each division of the graph is equal to 5% of the bottom it has last touched. After forming the bottom, when the price rises one division, i.e., 5%, the scrip is to be bought. After forming a high, when price falls one division, i.e., 5%, the scrip is to be sold. In the graph, the gross profit derived in the deal amounts to 6 divisions, i.e., 30%. We can describe this profit as market-wide, since you took all the profit that was possible within that market movement or price movement.

A note about the graph. The graph given above is only illustrative and is not exact. The divisions which the price, rising from the last formed bottom, makes are bound to be smaller than the divisions which the price, falling from the last formed high, makes. While on the ascent, the divisions will be based on the last formed bottom, while on the descent, they will be based on the last formed high. The two differing scales ought to have been used in the graph, but haven't, solely because the graph is just for illustration.

Let me ask: In the above mentioned case, what made you buy the scrip and what made you sell the scrip? Only the price movement did. After forming the bottom, the price climbed 5%, and it made you buy the scrip at that level. After forming the top, the price fell 5%, and it made you sell the scrip away. You were going in tandem with the price movement. When the price started rising, you bought the scrip. When price continued its ascent, you held on to the price. When the price started falling, you sold the scrip. When the price continued its fall, you had wisely separated yourself from it.

Thus you had put in place a well defined policy to buy when price rises 5% from its last formed bottom, and to sell when price falls 5% from its last formed high. You adhered to the policy, and the rest was done by the price movement. The policy made you cling to the scrip whenever it climbed and to distance yourself from it while it crashed.

In the above given illustration, what would have happened if you had not made the purchase when the price had risen by the first division, i.e., when the price had risen 5% from the last formed

bottom? The answer is simple: you would have denied yourself the opportunity to earn profit. One more similar question: what would have happened if you had not sold the scrip away when the price fell by one division, i.e., when the price fell 5% from the last formed top? Here also, the answer is simple: if you had not sold the scrip when it fell 5% from the last formed top, your profit from the deal would have diminished. Had you remained invested while the scrip retreated all the way back to the old low, you would have even incurred loss.

The lesson to be learnt from all this is that both buying and selling must be made at the appropriate times without fail. Any hesitation will, most of the time, adversely affect your prospects.

You bought the scrip when it rose 5% from the last formed bottom, and you sold it away when it fell 5% from its last formed high, and, in the process, earned market-wide profit. This was the maximum you could have done in the given circumstances. You have done the maximum possible, and you have gained all of the market-wide profit. Adhering to the theory or system should be your aim all the time. Needless to add, you should readily suffer the system-given loss, too, while you confidently earn whole of the system-given profit.

The system, or the theory and its practice, helps you earn market-wide profit. It also helps you limit your losses. What is the maximum loss you would incur if a deal ends in complete loss? Let us calculate it. Let us go back to the simple example mentioned in the preceding chapter. A scrip forms a bottom at Rs. 100 and then rises 5% to Rs. 105, and let us imagine that you are buying the scrip for Rs. 105. Let us also imagine that soon after your purchase, the scrip crashes to, say, Rs. 70. But, according to our theory, you would have sold the scrip away, when the price fell 5% from the last formed high of Rs. 105; for the sake of convenience, let us take this level as Rs. 100 itself. So, you would have sold the scrip away when it fell from Rs. 105 to Rs. 100. The deal ended in loss. The loss came to 5% of the purchase price of Rs. 105.

The price had fallen further to Rs. 70, and the fall was equal to, more or less, 35%. If you had not sold the scrip away when it fell to Rs. 100, you would have incurred a heavy loss of 35%. You followed the system, sold the scrip away when it fell 5% from the last formed top, and thus limited your loss to just 5%. In other words, the system limits your losses; it limits your risk. In my view, this is the greatest advantage of my theory.

So, two are the main advantages of the theory or system which I advocate: (1) it helps you earn market-wide profit. (2) It helps you to limit your losses. Both these advantages are capable of giving you the kind of growth which investment in other fields or sectors seldom give over the long term. "Over the long term", I said. Because, never think that you will be able to attain very high growth in a matter of months. Set your sight over a period of 5 to 10 years. Follow the system religiously. If you do, you will get market-wide profit. Of course, there are other conditions involved. One of them is to select the right scrip. Another condition is to deal in multiple scrips. Another condition is to be present in the market throughout the trading hours. There are some other risks involved, too, I shall come to all this one by one. Before I do, I must explain what a stoploss sell order is, as per the promise given in the preceding chapter.

Let us take a simple example. You have bought a scrip for Rs. 100. As soon as you buy a scrip, you have to treat the buying price as the last formed top, and enter a sell order 5% below the buying price. Only then will your risk of loss be limited to 5%. Accordingly, in the case on hand, you have to enter a stoploss sell order at Rs. 95. If the price falls from Rs. 100 to Rs. 95, your shares should get sold, this is the intention.

A stoploss buy order had needed two prices: one was the trigger price and the other was the limit price. Similarly, a stoploss sell order too requires two prices: one is the trigger price and the other is the limit price. Rs. 95 is the level at which you want your scrip to be sold away if price falls from Rs. 100 to Rs. 95. So, Rs. 95 should be entered as the trigger price. For the convenience of illustration, let us decide Rs. 94 as the limit price. Thus the stoploss sell order will be entered, with Rs. 95 as the trigger price and Rs. 94 as the limit price.

When the price falls to Rs. 95, the stoploss sell order will get triggered and the sale will start taking place. The sale can take place at every tick price, ranging from Rs. 95 to Rs. 94. We must also anticipate the possibility of the whole quantity getting sold at the limit price of Rs. 94. We have to put up with this risk. Though it is a risk, it may not cause us much harm in the long run.

The chances of the stoploss sell order getting executed depend on the quantity the prospective buyers have bid for. You can sell something only when somebody is ready to buy it. When there is no buyer, you can't sell. In the same way, if the total quantity of buy orders within the range of Rs. 95 to Rs. 94 are not sufficient to meet the quantity in your stoploss sell order, the stoploss sell order will get executed only to that extent. In other words, the stoploss sell order will get executed only partially. That part of the stoploss sell order, which has not been executed, will immediately get automatically converted into a normal sell order for the limit price of Rs. 94; this normal order will remain pending and will get executed if the price (which must by then have gone below Rs. 94) rises to Rs. 94, that is, if buyers come forward to buy the remaining quantity for Rs. 94.

I must repeat here what I had mentioned while explaining stoploss buy order. Stoploss orders will work well only in the case of scrips which regularly have heavy volumes. There must be large quantities on offer for both sale and purchase, at its every tick price. If large quantities of the scrip are regularly traded, the stoploss orders will work well. When large quantities of the scrip are regularly traded, chances for the stoploss buy orders and stoploss sell orders to get executed on their trigger prices themselves will increase. Stoploss orders might prove to be disastrous in low volume scrips. Low volume scrips should not be selected for implementing the system.

In the simple example given above, Rs. 100 was the last formed top, and hence Rs. 95 was the trigger price and Rs. 94 the limit price in the related stoploss sell order. Let us imagine that the price rises from Rs. 100 to Rs. 101. Immediately, we must modify the trigger price and the limit price to that extent. Thus, the revised trigger price should be Rs. 96 and the limit price should be Rs. 95. If the price rises further to Rs. 102, the trigger price and the limit prices should also be, accordingly, raised to Rs. 97 and Rs. 96 respectively. In other words, whenever the last formed top or high rises, the trigger price and the limit price of the pending stoploss sell order should also be raised to take advantage of the rise in the top. This is how we follow the price movement and ensure market-wide profit.

Price moves on NSE in multiples of 5 paise. When the price rises by 5 paise, you can revise the trigger price and limit price of the pending stoploss sell order. Nothing prevents you from revising the trigger price and limit price whenever price rises 5 paise or 10 paise. However, if you are in a trading hall, then you might find it difficult to ask the terminal operator to revise the pending stoploss sell order (or stoploss buy order) every time the price moves 5 paise or 10 paise favourably. You can wait and get the pending stoploss orders revised when the price moves 1% or 2% adversely. Sometimes price movements can be abrupt. So, care must be taken to keep the orders updated in accordance with the theory, while care must also be taken to reduce the load on the terminal operator.

Trading from home, using one's own internet, will be the most convenient method. But for it, you need to have a fast computer, a fast and reliable internet connection, a UPS that can give you enough power throughout the trading hours, in case the normal electrical supply fails throughout the trading hours. The intention is to keep all your stoploss buying and stoploss selling orders promptly updated so that the distance between them and their respective highs or lows (as the case may be) is steadily kept at whatever your trigger percentage is. If the trigger you have chosen is 5%, the distance between the trigger price and the last formed high or low as the case may be, should always be 5% exactly. If the trigger you have chosen is 10%, the gap between the trigger prices and the last formed high or low, as the case may be, should always be 10% exactly.

When the last formed top rises, the trigger price and the limit price in the related stoploss sell order must be raised in tandem with the rise in the top. Likewise, when the last formed bottom falls, the

trigger price and the limit price in the related stoploss buy order must also be lowered to that extent.

The next few chapters will deal with scrip selection, dealing in multiple scrips, trading from home, etc.

(To continue)