The Wonderland of Equity and Real Estate Investment

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Abstract

The Equity investment is an avenue where even a common man has an opportunity to enter the wonderland of investment with his meager savings. Common investors in the stock market generally rely on rumor, tipsters and manipulators. They rarely use the marvels of modern technology which to a great extent are in favour of genuine investor. There is no other avenue of investments that offers better returns than equity stock market. The Real Estate investment is other end of investment where the entry is for financially sound investors. The present paper tries to offer a bunch of a few suggestions with which a sensible, patient and disciplined investor can earn a few bucks.

Keywords: Equity market, Speculation, Investment Avenue, Investor Risk, Diversification Blue chip shares

Introduction

The present paper is intended to help beginners invest effectively in stocks and seasoned investors to revisit and reinforce certain crucial aspects of equity investment.

Much has changed in the Indian stock market over the last few decades. But none of these changes have hindered the implementation of the ideas in this paper. On the contrary, the marvels of modern technology and better regulation have worked in favour of a genuine equity investor, who is willing to use a little common sense and self-discipline in equity investment.

Essentially, the investors are advised to choose investment over speculation; to invest in the Indian economy by constructing a well-
diversified portfolio of blue chip stocks; to buy and then hold on to these stocks for the long run; to reinvest dividends; to invest with a margin of safety; to have a regular programme of investing during their financially productive years; to ignore stockbroker 'tips', 'research reports' and other day-to-day noise in the equity markets; to eschew day trading, margin trading, trading in derivatives, commodities and currencies, and other assorted forms of financial market madness; and to aim for optimum returns, rather than attempt to get rich quick.

**The stock market as an avenue of investment**

Common investors in the stock market routinely rely on tipsters and manipulators, little realising that an overwhelming majority of 'experts' are sadly innocent of sound investment knowledge. Most stock brokerages flaunt 'research' departments that are of questionable value. Their *raison d'être* appears to be to make investors trade more and more, so that higher brokerages are earned. The golden principle of stock market investment is that, in a boom, you do not need the advice of experts to make money. Any trash you buy will appreciate. In a recession, the advice of the best experts will not prevent you from losing money.

Should then, a self-respecting investor keep away from the stock market? The answer is an emphatic NO! The stock market is a legitimate avenue of investment. Equity, real estate and your own business are three avenues that have consistently beaten inflation and genuinely enhanced wealth in the long run. Business of course, is not for everyone. But it would be difficult to find another avenue of investment that offers better returns than stocks, to a sensible, patient and disciplined investor.

**Investment vs Speculation**

Why then, do so many “investors” lose in the stock market? The answer is simple. Those who lose are not investors, but speculators. The stock market provides opportunities not just for investment, but also for speculation. Most investors fall prey to the temptation of quick riches through speculation. In the process, they almost always encounter quick poverty. Today, day traders, margin traders and
punters in the derivatives, currency and commodities markets embody the essence of what a genuine stock market investor should not be!

If speculation is an activity of enduring value, it could be supported, but the sad fact is that it is not. In the short-run, speculative actions affect market sentiment hugely, leading to distortions in stock prices. But in the long run, reality, rules, says John Bogle, founder chairman of Vanguard Mutual Fund and author of the investment classic “Common Sense on Mutual Funds”.

So, insiders in the stockbrokerage business never tire of repeating to their employees that, “The more you churn, the more you earn”. That is why the stockbrokerage industry harps on the “virtues” of tips, research and frequent trading. John Bogle succinctly summarises the game that is being played on often unsuspecting investors, when he states: “Much of the (investment) industry is engaged in a hell-bent mission to take hold of the finest instrument ever created for long-term investing (equity), and transform it into a vehicle for intermediate-term, and even short-term speculation.”

So let us sound a simple caution at the very outset: If you try to 'play' the stock market, you'll soon discover that it is the stock market that's playing with you.

Jason Zweig, internationally renowned author and writer on financial matters, states: “Day trading — holding stocks for a few hours at a time — is one of the best weapons ever invented for committing financial suicide. Some of your trades might make money, most of your trades will lose money, but your broker will always make money.” He also says, “Speculation becomes mortally dangerous the moment you begin to take it seriously”.

So when you get the urge to speculate, remind yourself that you are undertaking an activity whose role over time is — well, nothing from your point of view, but everything from your stockbroker's point of view. Jason Zweig warns that “People who invest, make money for themselves. People who speculate, make money for their brokers. And that in turn, is why Wall Street perennially downplays the
durable virtues of investing, and hypes the gaudy appeal of speculation.”

The Real Risks in Equity Investment – Stockbrokers and 'Researchers' (or should we call them 'Risk Searchers'?)

One of the most poorly understood concepts in the stock market is RISK. The risk in stock speculation can be far greater than you imagine. The risk in equity investment on the other hand is far less than you fear. In fact, as an old stock market saying goes, “The great long-term risk of stocks is, not owning them.”

No one can predict the stock market in the short term. In the long run, predicting the market is relatively easy. Long-term stock market returns are a total of the current dividend yield and the rate of growth of corporate earnings. Charles D Ellis, author of 'Winning the Loser's Game' mentions: “The stock market is fascinating and quite deceptive – in the short run. Over the very long run, the market can be almost boringly reliable and predictable.”

In stock investments, the uncertainty of return reduces with time. In most other investment avenues, the uncertainty of return increases with time. So one can reduce risk, eventually eliminate it, and earn returns from a diversified portfolio of quality stocks, by the mere activity (or inactivity!) of holding on to it, and reinvesting the dividends you earn along the way.

Do you think the worthies in the stockbrokerage industry do not know this? Of course they do! Then why do they give advice contrary to long-term, buy-and-hold investing? Perhaps the answer lies in this statement of author Upton Sinclair: “It is difficult to get a man to understand something, when his salary depends upon not understanding it.” Remember this the next time you have the misfortune to encounter a tele-salesperson, 'relationship manager', insurance agent, mutual fund distributor, stockbroker's salesperson, portfolio manager ('damager'?!), wealth manager, equity researcher or any other fancifully titled peddler of financial 'products'.

There is old English saying that is apt here: “Never buy anything from someone who is out of breath.” If something is sold
aggressively, it may be hardly worth buying. Something authentic and valuable does not need to be sold. It will be bought. Likewise, the top financial professionals will never stoop to selling. They do not need to, because people will flock to them for their expertise. You will have to approach them on their terms if you want their services. So reflect for a moment on what the caliber of those actively and aggressively pushing financial products is likely to be.

**How do you invest in the stock market?**

If you are one of those who would like to invest in the stock market, here are a few rules that have proved themselves useful and effective over not decades, but centuries.

These rules are -

1. Diversify across 10 to 20 major economic / industry sectors
2. Have Equity investment time horizon - at least 5 years
3. Select only the top blue chips
4. Reinvest dividends
5. Plan—When and how much to invest
6. Review the portfolio

**1) Diversification**

The first rule employs the risk management tool of diversification. It does not mean that an investor must start equity investment with 10 to 20 major sectors straightaway. However, an equity investor must build a portfolio across 10 to 20 major economic or industry sectors over a reasonable period of time.

**Why 10 to 20 sectors?** Around 2,800 stocks are traded on the Indian stock markets, daily. These companies can be divided into 100 to 120 sectors. The ideal equity model argues that a sample of between 10 and 20 per cent of these sectors is more than enough to build a good equity portfolio. The model also stipulates that the sectors chosen should be major sectors, e.g., steel, cement, power, engineering, pharmaceuticals, software, banking and finance, fast moving consumer goods, automobiles, etc., rather than minor sectors like
aquaculture, cigarettes, dyes and pigments, glass products, leather products, moulded luggage and so on.

**How much should you diversify? And why arguments against excessive diversification are bogus**

The total risk in the stock market can be of two types: Systemic Risk (formerly called Systematic Risk) and Non-Systemic Risk (formerly called Unsystematic Risk). Systemic Risk affects the stock market system as a whole. For example, if war breaks out or corporate income-taxes are increased sharply, the entire market will be affected adversely. These are examples of systemic risk.

Non-systemic Risk affects a particular company or sector or industrial group only, and not the entire market. Accounting frauds, family squabbles in family-owned businesses, mismanagement, poor prospects, intense competition or gluts, and government policies unfavourable to a particular sector or company, are examples of non-systemic risk.

Non-systemic Risk can be managed very effectively through diversification. If a portfolio is diversified across 30 blue chip stocks spread over at least 10 major economic or industry sectors, non-systemic risk is substantially reduced. But if the portfolio is diversified across at least 60 stocks spread over 20 or more major economic or industry sectors, non-systemic risk can be virtually eliminated.

Systemic Risk is much more difficult to manage, but can be tackled with reasonable success, by systematic or recurring investment, which is nothing but diversification across time.

**2) Equity investment time horizon**

The second rule cautions the investor that equity is a long-term investment avenue, with a minimum time horizon of at least 5 years. An investment time horizon is a time element attached to each avenue of investment, which if adhered to, eliminates risk and delivers optimum returns. The lure of speculation misleads most 'investors' into seeking maximum returns. Sadly, they end up with minimum returns or, far likelier, substantial losses. On the other hand, there is such a thing as an optimum return, a concept investors ignore at their
peril.

Stock markets have a history of more than 400 years. We need not calculate the average return for that period. But being aware of average stock market returns for the last 30 to 60 years is a useful indicator to gauge optimum returns. Most investors who seek to obtain optimum returns from their equity investments find that in the long run the actual return they get is very often appreciably greater than optimum.

Of course, if an investor makes substantial profits before the time horizon runs out, he can always liquidate his investments, if need be. A time horizon of at least five years only means that the money reserved for equity investment, should be money that the investor does not ordinarily need for at least 5 years. It appears that too much importance is given to booking profits and market timing. Investors are advised to exercise their discretion and decide - when to sell.

Legendary stock market investor Warren Buffet remarked that his "favourite holding period is for ever.” The most successful investors we have seen are those who have followed Buffett's dictum, accumulated equity investments over thirty or forty years or more, and never sold! These investors now earn dividend income and have long-term capital appreciation that is more than enough to see them through retirement very comfortably!

**Why at least 5 years**

History shows that generally, a boom and recession cycle in the stock market takes an average of 5 years to complete. That is why a period of at least 5 years has been estimated to be a reasonable minimum time horizon for equity investment. A time horizon of 'at least 5 years' only means that the money reserved for equity investment should be money that the investor can afford to block for at least 5 years.

**3) Select only the top Blue Chips**

The third rule is equally important, because most investors have a problem of stock selection. They always ask a broker which share to buy. Instead of this, it is better to choose only blue chips Blue chips
are stocks that are the best in their class or sector. Blue chips need not necessarily be large-cap companies. Where should you choose stocks from? The 200-stock indices of either the Bombay or National stock exchanges should be a more than adequate basket from which to construct your portfolio.

**Why only Blue Chips?**

Because blue chips are liquid. They are generally around for the medium to long-term. They attract the best management talent. More often than not, they have the highest standards of corporate governance. They focus on enhancing shareholder value. They are adept at managing rapidly changing business, economic, fiscal, tax and political environments. They generally contribute heavily to the state exchequer through both direct and indirect taxes. They provide considerable employment.

These qualities give blue chips significant economic impact. Economic impact simply means the strength to lobby effectively with the powers that be, for legislative and policy changes required to meet challenges during recessions and other difficult times. Economic impact also means that the company is so important that its failure will have an adverse effect on the entire economy.

**4) Reinvest dividends - Do not spend them**

The fourth rule encourages investors to reinvest dividends. Equity is a growth avenue, not an avenue that is designed to provide regular returns. Dividends received, even though they may be relatively small sums, should be collected and reinvested in the stock market, whenever they accumulate to meaningful amounts.

According to research by Crandall, Pierce & Company, an investment of one US dollar in the S&P 500 stocks on 31st May 1946 would have been worth $ 47.53 on 31st July 2002, had dividends not been reinvested. Had dividends been reinvested, the $ 1 would have grown to $ 405.92 in the same period! That is why Benjamin Graham has enlightened us that, “Far from being an afterthought, dividends are the greatest force in stock investing.”

It is advised to have a separate savings bank account registered with
the depository participant where you have your demat account. Dividends will be credited to this bank account. Do not use the said bank account for any other purpose. This helps you to easily collect, account for and reinvest dividends.

5) When and how much to invest

Investment should be made uniformly across sectors. Because, at any given time in the stock market, the spotlight is on just one or two sectors which are fancied at that time. Most stock market players dabble only in these fancied sectors. However, the spotlight can shift to other sectors, without warning. It is very difficult for an individual investor to predict these changes in market fancy. It is also difficult for ordinary investors to predict how changes in business, economic and tax policy will affect the collective psyche of the stock market.

Therefore, one can easily implement an investment model by simply investing equal amounts (a minimum of Rs 20,000/- per stock would be viable today) in each of the stocks listed at the end of this paper. In order to build a satisfactory portfolio therefore, one would need a minimum of Rs 6 lakhs, for 30 companies. The ideal portfolio will be Rs 12 lakhs for 60 companies. One can start with smaller amounts, provided your ultimate objective is to build a portfolio of approximately 60 stocks.

The common investor is generally unable to gauge the impact of such changes on the various sectors of the economy. The first two rules of this model stipulate that only major sectors and top blue chips be chosen. Once this is accomplished, it is better to allocate equally between these major sectors, because in a time horizon of five years or more, all major sectors and blue chips have an even chance of performing well and therefore hogging the limelight. So, a prudent investor would do well to spread his investment uniformly across a minimum basket of 10 to 20 major sectors.

When to invest?

You may have a lump sum to invest in equity. Or you may be one of those individuals with a steady income in the form of salary or rentals, and desire to invest regularly. These two situations are not the same. They need to be addressed using different strategies.
Lump Sum Equity Investment – Invest only with a 'Margin of Safety'

Benjamin Graham insisted that lump sum equity investment must be made only with a 'margin of safety'. Graham's calculation of the margin of safety was quite complicated. Reduced to a thumb rule however, the margin of safety cautions investors to ensure that they do not pay too high a price for stocks.

After the Great Depression of 1929-32 in the US, the largest falls in the world's equity markets have been approximately 50 percent from peak to bottom. Falls of this magnitude occur rarely. Ever since 1st April 1979, from which date the Bombay Stock Exchange 30-stock Sensitive Index has been calculated, falls of 50 percent have occurred only on three occasions – in financial years 1992-93, 2000-01 and 2008-09. Half of this maximum fall, that is 25 percent from peak, can be a sensible margin of safety. Falls of 25 percent from the last peak happen significantly more often than falls of 50 percent.

The last peak for the BSE Sensex was 29,682 (closing value) points on 29th January 2015. The margin of safety would therefore kick in at 25 percent below this level, at 22,262 points. So lump sum investment in the stock market should be attempted only at this level.

One additional safeguard is advised. Ensure that the price-earnings ratios of the leading indices such as the BSE Sensitive Index and the NSE-50 Index or Nifty are below 20, in addition to these indices being 25 percent below their peak, to confirm the margin of safety.

Margin of Safety

The 'margin of safety' is applicable only to lump sum investment and not to systematic, recurring or periodic investment, provided the systematic investment programme is continued without interruption for at least five years. In short, systematic investment into equity can be started at any time. The only stipulation is that once started, it must be continued uninterrupted, for a minimum of five years, and preferably for much longer periods.

It can be observed that virtually all common investors mainly invest when the market is at its peak, and withdraw from the market, often in
panic, when it crashes. Actually, investors should do the reverse, but some behavioural self-destruct switch seems embedded in all of us! Systematic investment enables the investor to obtain better market pricing automatically, by buying more stocks when the market is low and less when the market is high. The result is that erratic investor behavior is controlled and corrected without the investor even being aware of it! Systematic investment also makes investment a habit, through regular, disciplined investing. There is great value in cultivating such a habit.

Finally, whether for systematic or lump sum investment, there is always a minimum viable amount. In the present scenario, this minimum, in our opinion, would be at least Rs 20,000/- per month. You must first see whether you are comfortable with this amount before embarking upon direct equity investment. If not, stick to equity index mutual funds or well diversified equity mutual funds.

The second option is to invest systematically. If you are investing systematically, the minimum amount must be Rs 20,000/- per month. You must be able to sustain this investment for a minimum of 60 months. If you want to invest more than Rs 20,000/- per month, that is fine. If you want say Rs 30,000/- of a stock per month, go right ahead.

But if you can afford Rs 40,000/- per month, it is better to purchase two stocks of Rs 20,000/- each at intervals of a fortnight, for better diversification. Once you complete investing in the entire list of recommended stocks, you can start again from stock number 1.

Now look at the way the stocks are arranged in our list of recommendations. The first stock is from services, the second from manufacturing, the third from services, the fourth from manufacturing and the fifth from agriculture/agrochemicals/dairy products/food. So by the time you have purchased five stocks, you have made one round trip of the economy. You will find that the next lot of five stocks is similarly arranged, and that's how the strategy progresses, to the extent it can diversify across the said three economic segments.
Once you invest in the economy through a well-diversified portfolio of blue chips, do not worry about the performance of individual stocks. Diversification and an adequately long time horizon will work at both risk reduction as well as return optimization.

6) Review the portfolio

The sixth rule is about reviewing equity investments. Regular reviews keep an investor constantly aware of the state of his portfolio and the risk and return thereof. Reviews also alert the investor to opportunities for further investments which can enhance the value of a portfolio. Finally, 'reviewing' is not 'tinkering.' Long-term equity investment with regular reviews makes investors wealthy.

Tinkering makes brokers wealthy, often at the cost of investors! 'Reviewing' is being aware of one's portfolio and its performance on a regular basis. From our experience, additional investment needs to be made only upon a drop of at least 25 per cent in the index, from the date of original purchase, or upon a drop of 25 percent from the last index peak, depending upon when the investor has made his original investment.

**Buy and hold a well-diversified portfolio of blue chip stocks from major economic segments and industry sectors**

The 'buy-and-hold' is the simplest, oldest and best strategy ever invented for equity investment. What must you buy? Focus on blue chips.

In addition, the long-term capital appreciation on their equity portfolios is more than enough to see them through retirement very comfortably, and also leave substantial legacies. All this, despite several companies in their well-diversified portfolios having fared badly, and several having been liquidated!

**Why major economic sectors?**

Because these sectors have a significant role to play in the economy of the country. They are under constant scrutiny of the government, regulators, the press, the public and a gaggle of economists, all of whom have a stake in ensuring their healthy growth. Neglect of major economic sectors could mean recession, which no government...
in its right mind would want to usher in.

**Booking profits**

When do you sell an equity portfolio? Many books of dubious value with titles like "It's when you Sell that Counts" have been published. Buffett has repeatedly said that "the correct holding period for stock market investments is forever". Profits in quality equity portfolios need never be booked. A lifetime of steady investing will probably provide more than enough dividend income to comfortably take care of normal living expenses in later years.

Dividends are also much more stable than stock prices. They increase over time, generally at a rate that is in excess of inflation. Undoubtedly, companies, like human beings, have a lifespan. The concept of 'perpetual existence' that is supposed to be a cornerstone of the corporate structure is a highly iffy notion. Companies can be taken over, merged, amalgamated, sold. Companies may also dispose of ('demerge' is the inelegant term used) certain divisions, change their names and ownership structures and even go into liquidation. All this occurs with unbecoming regularity for entities with an allegedly perpetual existence.

Should the gymnastics in the corporate world affect you? In your portfolio there will be stocks that do extraordinarily well, stocks that lag behind in performance and other stocks whose performance is middling. This is normal portfolio behavior. Once you have constructed a quality portfolio, do not get perturbed about the performance of individual stocks. Remember, it is portfolio returns that are important, not the returns of the individual stocks in the portfolio.

Your equity portfolio can certainly be realigned to a model portfolio like the one in the list at the end of this paper. Your equity portfolio can also be realigned to a well-diversified index. The 200-stock indices of either the Bombay or National stock exchanges should do nicely here. However, do not undertake portfolio realignment often, as you will only incur expenses and run the risk of developing a trading mentality.
Realignment once in five years is more than enough. Until then, give time a chance to work for you. In the interim, do not worry if one or two companies do very badly or even go into liquidation. At the cost of being repetitive, let us drive home the point that it is portfolio performance that matters, not the performance of the individual components thereof. To be a truly successful stock market investor, you must one day reach the stage where dividend income takes care of your normal expenses and your equity portfolio either passes on to your descendants or is left to charity.

**A word about the recommendation list**

Before we unleash our list of recommended stocks on you, a few concluding thoughts from the greats. Warren Buffett says that investing is a marathon, not a hundred metre sprint. He also mentions that it is not necessary to do extraordinary things to get extraordinary results. An old investment saying reminds us that the ultimate objective of good investing is to obtain above average returns, with below average risk.

Frank Netti says that sound investment will decrease the time during which you work for money, and increase the time during which money will work for you. We hope this paper has given you some insights into what genuine equity investment is all about. We have tried our best to remain true to our mission of translating the ideas of the finest equity investors and advisers into a practical plan of action for the common investor. Our list of recommended stocks appears overleaf.

**Now, the story of real estate investments**

Equity is a growth investment. It is designed to increase the wealth of its owner over a period of time. Any growth investment must have two attributes. The first is a principal value that will fluctuate, sometimes violently, in the short-term, but grow in the long-term at a rate equal to or greater than inflation. The second attribute is an income stream which may fluctuate in the short run but will grow in the long run, once again at a rate that is equal to or greater than inflation. Therefore, to merit the term 'growth investment', there must not only be a principal amount invested but also an
accompanying income stream. Thus, stocks yield dividends. Real estate properties purchased as investments must yield rentals.

Real estate is an excellent, long-term, wealth, enhancing avenue of investment. However, it suffers from some obvious and other not-so-obvious drawbacks.

**The obvious drawbacks include:**

- Poor liquidity. Even in the most frenzied real estate boom, it is not easy to purchase and sell real estate. During a recession in the real estate market on the other hand, liquidity simply evaporates.

- Title. Despite best efforts and the opinion of legal and other experts, being absolutely sure about clear title to a real estate property can be challenging.

- A large amount of capital is required for a single purchase.

- Large amounts are also required for additional purchases even in a real estate market that has fallen sharply.

- Black money is a menace that lurks behind almost all real estate transactions.

- High stamp duty on purchases of real estate. If you purchase Rs 100 lakhs worth of equity shares, they are credited to your demat account without further cost. But if you purchase real estate worth Rs 100 lakhs, in the state of Karnataka at least, you will spend an additional Rs 7 lakhs approximately to register the transfer of the title thereof in your name.

- Purchase and sale formalities in real estate are time consuming and cumbersome.

- Real estate has certain administrative difficulties. For example, squatting, encroachment, fraud and criminal intimidation by the land mafia and a number of other problems, especially involving absentee landlordism.

**The not-so-obvious drawbacks of real estate investing are:**

First, misleading returns where income from either capital appreciation or rental is concerned. The maintenance of physical real
estate can be quite heavy. Any developed structure like an apartment or commercial premises requires periodical painting, repairs, renovation, payment of property taxes, etc. Very often, the owner does not relate these expenses to the income received from the property. The expenses are met out of normal income from employment, business or profession. The owner only thinks of the gross return that he is getting, without realising that the net return may be considerably less.

Second, thanks to the Securities Transactions Tax (STT) which at present is so negligible as to be laughable, stock market investment escapes capital gains tax in India. Real estate investments are not so fortunate. Even after cost inflation indexing and all other tax avoidance measures, long-term capital gains taxes can be substantial.

Third, the greater the holdings of real estate, the more the hassles of maintenance, dealing with tenants, complaints from tenants or neighbours, etc., especially as real estate investors advance in age. There are instances where wealthy individuals who have sold real assets just to reduce stress caused by their holdings, and not because they needed the money.

Regarding reinvesting rentals during one's active working life. It is difficult to reinvest rentals back into real estate, in view of the cost involved, unless a housing loan is taken and existing rentals go towards paying the loan installments. Alternatively, several real estate investors channel rentals into either stock or equity mutual fund investments on a systematic basis, which is an excellent idea.

There is also a trend today of youngsters studying, working and settling abroad. This makes it even more difficult for ageing parents to look after real estate assets in India, especially if such assets are spread over 2 or 3 cities or states. Children who are settled abroad for a considerable time are very often not interested in the real estate assets of their parents in India. Transmission of these assets to the children after the lifetime of the parents is neither quick nor easy.

No wonder Benjamin Graham enlightens us that, “Far from being an afterthought, dividends are the greatest force in stock investing.”

**Should one go in for real estate investments?**

The best advice on this subject is that human beings can be broadly
divided into two categories where real estate is concerned. The first category has a special interest in, very often coupled with a talent for, real estate investment. If you fall into this category, you can by all means invest in real estate, bearing in mind that the real estate investment time horizon is 10 years. In short, you should be prepared to block your investment for at least 10 years, if required, in order to obtain optimum returns.

But if you fall into the second category of individuals, who have no interest whatsoever in real estate, then you would be well advised to purchase real estate only to the extent that you have a use for it. One use of real estate is universal. Everyone requires a residence. So it is incumbent upon everyone to acquire a dwelling.

In addition, a person in financial services, or a chartered accountant or physician, would require an office. So, this individual must try to eventually own both a residence and an office. Take one more example, of a person who designs, manufacturers and markets furniture. Such a person requires a residence, some sort of an old structure or shed in a non-prominent area, even a little away from the city, where the furniture can be manufactured, and a showroom in a high-visibility commercial area in the city, where the furniture can be displayed and marketed. This person must ultimately try to own all three premises because he has a use for all three.

Consumption vs Investment in Real Estate:

One residential apartment or house is not considered as an investment because it is consumed for the residence of the individual and his family. Many people do not realise that the considerations when purchasing real estate for consumption are dramatically different from the considerations when purchasing real estate for investment.

When purchasing real estate for consumption, price may not be the sole deciding factor. It is okay to pay even a fancy price, if the premises is in an outstanding location with good facilities and conveniences and if all members of the family agree that the premises in question is close to their concept of a dream home. Since the happiness of the family cannot be measured in terms of money, resources permitting, it is okay to pay a price that is higher than the fair market value.
But when purchasing real estate for investment, it is only investment considerations that must apply. The best advice here comes from Professor Burton Malkiel, Princeton professor of economics and author of the investment classic “A Random Walk down Wall Street”. Professor Malkiel says that **real estate must be purchased as an investment only if the rental yield is equal to or greater than the yield on short-term bonds.**

For example, the cost of a 2-bedroom apartment in Mangalore today would be Rs 75 lakhs. You can get a rent of Rs 16,000/- per month or Rs 1.92 lakhs per annum on this apartment. The rental yield therefore is: Rs 1,92,000 / Rs 65,00,000 x 100 = 2.56 percent. This has to be compared with the yield on short-term bonds which is presently about 6 percent per annum. If you cannot easily ascertain the yield on short-term bonds, the interest rate on the 6-month fixed deposit of any major bank will be a good substitute. Clearly, purchasing an apartment in Mangalore for investment is lunacy.

Now take the example of a friend of mine who purchased a shop in Bangalore some time back for Rs 55 lakhs, including registration costs. This shop fetches him a rental of Rs 40,000/- per month. The rental yield is 8.73 percent. At the time he purchased the property, the yield on short-term bonds was 7.5 percent. It was still a superb deal.

**Conclusion**

In this article, the theoretical framework to think about two horizons of investment viz, equity and real estate is presented. A prudent investor should weigh the pros and cons of these two alternatives and decide the avenue which is best suited for him.
Burton G Malkiel:

Dr William J Bernstein:

Roger C Gibson:

Charles D Ellis:

Benjamin Graham:

John C Bogle:
Thomas J Stanley & William D Danko
1. The Millionaire Next Door: The Surprising Secrets of America's Wealthy
   (Publishers: Pocket Books, a division of Simon & Schuster, Inc.)

Eric Tyson:

Website: www.berkshirehathaway.com - for the investment philosophy of Warren Edward Buffett, mainly contained in his annual letters to shareholders.

A N Shanbhag & Sandeep Shanbhag:
1. In the Wonderland of Investment, 34th edition
   (Publishers: Vision Books, Delhi)
2. In the Wonderland of Investment for NRIs, 16th edition,
   (Publishers: Vision Books, Delhi)

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