Investment Strategies In The Indian Stock Market: A Survey

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INTRODUCTION

Active investors continuously search for investment strategies that can provide returns greater than the market return. The goal of active equity management is to earn a portfolio return that exceeds the return of a passive benchmark portfolio on a risk adjusted basis. Hence, Investment managers can adopt different strategies based on fundamental analysis, technical analysis, market anomalies and security attributes.

Fundamental analysis is based on the premise that in the long term, market price of a share will approach its intrinsic value. Hence in fundamental analysis, intrinsic value of a stock is calculated to evaluate whether the stock is currently overpriced or under priced.

The three-step investment process begins at the top-with an analysis of broad country and asset class allocations and progresses down through sector allocation decisions to the bottom level where individual securities are selected. An alternative to this top-down approach to investing is a bottom-up process that simply emphasizes on the selection of securities without any initial market or sector analysis.

Using Technical analysis, active managers can form equity portfolios on the basis of past stock price trends by assuming that one of the two things will happen: (1) past stock price trends will continue in the same direction, or (2) they will reverse themselves. A contrarian investment strategy (documented by Debondt and Thaeler (1985,1987)) is based on the belief that the best time to buy (sell) a stock is when the majority of other investors are the most bearish (bullish) about it. In this way, the contrarian investor will attempt to always purchase the stock when it is near its lowest price and sell it (or even short sell it) when it nears its peak. At the other extreme, active portfolios can also be formed on the assumption that recent trends in past prices will continue. A price momentum strategy (Jegadeesh and Titman(1993)) assumes that stocks that have been hot will stay hot, while cold stocks will also remain so.

Rozeff and Kinney (1976) found that average stock return in January was higher than in other months of the year for the US stock market. Keim (1983) showed that the month of the year effect and size effect were related. Further, Ariel (1987) documented that stock returns tended to be higher, on average, in the first half of the month. However, Wong (1995) reported that this intra month effect did not exist in the Asian stock markets. Researchers such as Cross (1973), French (1980), Gibbons and Hess (1981) and Agarwal and Tandon (1994) found seasonality in daily stock returns i.e. stock returns were higher on a particular day of the week. This phenomenon has been termed as the day of the week effect. Ariel (1990) found that approximately one third of the total market return accrued on trading days preceding the eight holidays in the US stock market (pre holiday effect). Similar findings were reported by Lakonishok and Smidt (1984), Keim (1983) and Roll (1983). Cadsby and Ratner (1992) and Kim and Park (1994) showed that the holiday effect also occurred in Australia, Hong Kong, Japan and United Kingdom.

A more promising approach to active management is anomaly investing which involves forming portfolios based on various characteristics of the companies themselves. Two such characteristics which have been strongly documented in the stock market are the total market capitalization of the company (i.e. company size) and the financial position of the firm as indicated by its various financial ratios (e.g. P/E, P/B, D/E). Various studies such as Banz (1981), Basu (1977), Bhandari (1988), Stattman (1980), Rosenberg, Reid and Lanstein (1985) etc. have explored the feasibility of earning extra normal returns on risk adjusted basis using the above two sets of categories. In India, Mohanty (2001), Sehgal and Muneesh (2002), Sehgal and Tripathi (2005, 2007) have shown the availability of extra risk adjusted returns in Indian Stock market on the basis of size and value based investment strategies.

The objective of this paper is to examine various investment strategies used by investment analysts, fund managers and active equity investors in Indian stock market and to know their perceptions and preferences relating to various aspects of the Indian stock market.

SAMPLE AND METHODOLOGY

The sample comprises of 93 equity analysts, mutual fund managers and investors actively engaged in the Indian stock market. The survey had been conducted during March-October 2007. Due to the non-responsiveness of mutual fund managers, their participation in the survey has been very low. Out of the total sample of 93, there were

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8 (8.6%) mutual fund managers, 20 (or 21.5%) equity analysts and 65 (or 69.9%) investors actively engaged in stock market activities (Table 1). The convenience sampling method has been used for collection of necessary data. All respondents have been using investment strategies in Indian stock market and have a stock market experience ranging from 2 to 17 years. Majority of the respondents (60.9%) had 2 to 5 years of experience in the stock market.

For collection of necessary primary data, a structured questionnaire was prepared in due consultation with the experts in the field of stock market. Before finalization of the questionnaire, pilot testing had been done using a sample of five equity analysts and the questionnaire was suitably modified. A conscious effort was made to include both closed-ended and open-ended questions in the standard questionnaire so as to extract maximum possible information. However, in order to ensure high response rate, the size of the questionnaire had been kept relatively small, without compromising on the quantity of relevant information sought for the purposes of the study. The questionnaire was divided into 10 questions relating to the following broad parameters :

(i) Analysts, fund managers and investors' perceptions about Indian stock market regarding efficiency level, factors affecting common stock returns and other attributes.
(ii) Investment strategies used and/or recommended by respondents in the stock market.
(iii) Changes, if any, in the investment strategies of respondents in Indian stock market.

The results of the survey have then been utilized to conclude the following hypotheses regarding investment strategies.

(i) Investment strategies based on company fundamentals are more popular than those based on technical analysis.
(ii) It is well recognized that company fundamentals such as size, leverage, P/E and BE/ME ratio are important in explaining cross-sectional variations in equity returns in Indian stock market.
(iii) The investment strategies of investors in Indian stock market have undergone drastic changes in the past five years.

We have used frequency distribution, percentages and Likert scale for the purpose of data analysis.

SURVEY FINDINGS

The findings of the survey are discussed below :

1. Basis of Investment Strategies and Benchmark Portfolio

Table 1 shows that majority of the investors use both fundamental and technical analysis for devising investment strategies in the Indian stock market. Further, majority of the investors prefer to use Nifty as their benchmark portfolio. It is clear that most of the Indian investors have changed their investment strategies over the past five years probably in the wake of increasing integration of Indian stock market with that of developed countries and developments on the domestic front. Broadly, the following changes have been cited by the respondents in their investment strategies over the past 5 years.

(i) There has been a move towards fundamental analysis.
(ii) Investment horizon has reduced due to increased volatility.
(iii) Investment strategy has shifted from Blue chip stocks to emerging stocks.
(iv) P/E ratios are no longer the most important base for investment.
(v) Focus more on company fundamentals and hold for longer periods.

Table 1 : Respondent's Profile

(i) Designation

	Frequency	Percent
Analyst	20	21.5
MF Manager	8	8.6
Investor	65	69.9
Total	93	100.0

(ii) Stock Market Experience

Years	Frequency	Percent
2 to 5	66	60.9
More than 5 to 9	9	9.7
More than 9 to 13	9	9.7
More than 13 to 17	9	9.7
Total	93	100

(iii) Basis of Investment/Trading Strategy

	Frequency	Percent
Technical analysis	8	8.6
Fundamental analysis	16	17.2
Both	69	74.2
Total	93	100.0

(iv) Better Benchmark- Sensex or Nifty?

	Frequency	Percent
Nifty	65	69.9
Sensex	28	30.1
Total	93	100.0

(v) Has There Been Any Change In Your Investment Strategy Over The Past Five Years?

	Frequency	Percent
Yes	60	64.5
No	33	35.5
Total	93	100.0

2. General Perceptions About the Indian Stock Market

In order to understand the perceptions of respondents regarding various characteristics of the Indian stock market related to the objectives of the study, eleven statements were provided in the questionnaire and respondents were asked to rate their opinion regarding each statement on a four point scale from fully agree to fully disagree. The results are presented in Table 2. These results show that majority of the respondents believe that the Indian stock market has become semi-strong efficient. Most of the respondents believe that arbitrage opportunities are available in the Indian stock market. However, the respondents do not agree that equity prices in India fully reflect company fundamentals. It may be said that increasingly more and more investors have started believing that market factor is no longer "The" most important factor in explaining cross-sectional variations in equity returns in India. Majority of the respondents fully agree that other factors such as size, book to market equity, P/E ratio and leverage can better explain cross sectional variations in equity returns in India. This lends further support to our proposition that there exists a significant relationship between company fundamentals and equity returns in India (Tripathi: 2008). Majority of the respondents perceive that beta of Indian companies is highly volatile implying that past or historical betas of Indian companies may not be truly representative of the current market risk level. Majority of the respondents fully agree that equity returns are influenced by the investment or trading behaviour of Foreign Institutional Investors (FIIs). This finding is important in the wake of high volatility witnessed in equity prices in India in recent past due to the buying and selling pressures created by FIIs. Respondents also rule out the role played by retail investors in influencing equity prices in India. Results show that majority of the respondents perceive that equity prices in India are influenced by large and institutional investors while retail investors are only price takers. A vast majority of the respondents believe that systematic investment plans (SIPs) work well in Indian equity market. Hence, a small investor may be simply benefited by the concept of rupee cost averaging. Majority of the respondents (90.3%) perceive that investment and trading strategies of Indian investors have undergone drastic changes overtime. Most of the respondents believe that investment strategies based on technical analysis are more popular than those based on fundamental analysis. This might be because of the intuitive appeal of technical indicators and readiness to use.

Table 2 : General Perceptions About The Indian Stock Market (Please read FA = Fully agree , SA= Somewhat Agree, SD= Somewhat Disagree, FD= Fully Disagree)

S.No.	Statement	FA	SA	SD	FD	Total
1	Indian equity market has become semi -strong efficient.	57 (61.3%)	22 (23.7%)	8 (8.6%)	6 (6.5%)	93 (100%)
2	Arbitrage opportunities are available in Indian equity market.	43 (46.2%)	13 (14%)	31 (33.3%)	6 (6.5%)	93 (100%)
3	Equity prices in India fully reflect company fundamentals.	23 (24.7%)	20 (21.5%)	45 (48.4%)	5 (5.4%)	93 (100%)
4	Beta or market factor is still the most important factor in explaining cross sectional variations in equity returns in India.	32 (34.4%)	7 (7.5%)	39 (41.9%)	15 (16.1%)	93 (100%)
5	Other factors such as Size, Book to Market Equity, P/E, leverage etc. can better explain cross sectional variations in equity returns in India than beta.	50 (53.8%)	35 (37.6%)	8 (8.6%)	Nil	93 (100%)
6	Beta of Indian companies is highly volatile.	51 (54.8%)	33 (35.5%)	9 (9.7%)	Nil	93 (100%)

7	Equity returns are influenced by the investment and trading behaviour of FIIs.	52 (55.9)	33 (35.5%)	Nil	8 (8.6%)	93 (100%)
8	Retail investors have no role in influencing equity prices in India.	41 (44.1%)	13 (14%)	22 (23.7%)	17 (18.3)	93 (100%)
9	SIPs work well in Indian equity market.	64 (68.8%)	19 (20.4%)	9 (9.7%)	1 (1.1%)	93 (100%)
10	Investment and trading strategies of investors in Indian equity Market has undergone drastic changes over the past one decade.	53 (57%)	31 (33.3%)	1 (1.1%)	8 (8.6%)	93 (100%)
11	Investment strategies based on technical analysis are more popular than those based on fundamental analysis.	36 (38.7%)	42 (45.2%)	6 (6.5%)	9 (9.7%)	93 (100%)

3. Worthiness/Effectiveness of Various Investment Strategies Used By Indian Investors

In order to analyse the perception of respondents regarding the worthiness of various investment strategies used by Indian investors, we provided them with 21 such strategies based on company fundamentals as well as some technical indicators such as moving average and relative strength index and they were asked to rate their opinion as to how well these strategies work in the Indian context on a four point scale ranging from-very well to not at all. The respondents were also asked to specify if some other investment strategy not covered under the given 21 strategies works well in the Indian context. Table 3 shows that there has been a great support for size effect (or size based investment strategy) in Indian context as 93.5% of the respondents think that size based investment strategy works either very well or well in the Indian equity market. Contrary to size effect, value effect (i.e. BE/ME based investment strategy), Leverage effect (Debt equity ratio based investment strategy) and P/E effect did not find any such strong support from the respondents. We did not find any substantial support for any seasonality effect based investment strategy (be it January effect or April effect) in Indian stock market. Similarly, respondents do not agree that any 'Day of the week effect' works in the Indian equity market. While intra month effect did not find much support from respondents, there has been some support for pre-holiday effect in the Indian stock market. There has been a great support for momentum effect (past winners turn out to be future winners too) in the Indian context. Unlike momentum effect, the support for contrarian effect has not been so strong among the respondents. It is clear that investors tend to buy stocks which are expected to announce bonus issue and/or stock split, stocks which are most actively traded and stocks which have announced good quarterly results. There has been good support for investment strategy based on moving average analysis among Indian investors but the support for relative strength index (RSI) has not been so strong. Majority of the respondents believe that the investment strategy of following the investment behaviour of FIIs is beneficial. Investors also believe that buying stocks whose prices have gone down by 20% does not work well. This is another indication of the great support for momentum strategy in the Indian equity market. Almost all respondents favored the investment strategy of buying stock for which good news is expected. Besides the above mentioned investment strategies, the respondents specified the following strategies which they think work well in the Indian stock market.

(a) Buying stocks with low market capitalization to Sales ratios.

(b) Buying stocks of companies with good promoters & management.

(c) Buying stocks on the basis of financial ratio analysis.

Table 3 : Perceptions About Various Investment Strategies Used By Indian Investors (VW= very well, W= well, SW= somewhat and NA= not at all)

S. No.	Effect(Investment strategy)	VW	W	SW	NA	Total
1	Size effect (buy small cap stocks).	20 (21.5%)	67 (72%)	Nil	6 (6.5%)	93 (100%)
2	Value effect(buy high Book to market equity stocks).	7 (7.5%)	18 (19.4%)	28 (30.1%)	40 (43%)	93 (100%)
3	Leverage effect(buy stocks of highly levered companies).	11 (11.8%)	8 (8.6%)	54 (58.1%)	20 (21.5%)	93 (100%)
4	P/E effect (buy low P/E stocks).	20 (21.5%)	17 (18.3%)	31 (33.3%)	25 (26.9%)	93 (100%)
5	January Seasonality effect (buy stocks in December and sell in January).	7 (7.5%)	7 (7.5%)	48 (51.6%)	31 (33.3%)	93 (100%)
6	April effect(buy stocks in March and sell in April).	7 (7.5%)	15 (16.1%)	46 (49.5%)	25 (26.9%)	93 (100%)
7	Day of the week effect (buy Monday sell Friday).	Nil	Nil	32 (34.4%)	61 (65.6%)	93 (100%)

8	Intra month effect.	Nil	15 (16.1%)	35 (37.6%)	43 (46.2%)	93 (100%)
9	Pre- holiday effect.	21 (22.6%)	12 (12.9%)	26 (28%)	34 (36%)	93 (100%)
10	Momentum effect (buy past winners).	29 (31.2%)	43 (46.2%)	21 (22.6%)	Nil	93 (100%)
11	Contrarian effect(buy past losers).	15 (16.1%)	29 (31.2%)	32 (34.4%)	17 (18.3%)	93 (100%)
12	Follow the investment behavior of FIIs.	30 (32.3%)	34 (36.6%)	19 (20.4%)	10 (10.8%)	93 (100%)
13	Buy stocks whose price has crossed 52 week high.	15 (16.1%)	28 (30.1%)	50 (53.8%)	Nil	93 (100%)
14	Buy stocks whose price has gone down by 20%.	12 (12.9%)	8 (8.6%)	55 (59.1%)	18 (19.4%)	93 (100%)
15	Buy stock whose price has gone up by 20%.	28 (30.1%)	27 (29%)	16 (17.2%)	22 (23.7%)	93 (100%)
16	Buy stock for which good news is expected.	42 (45.2%)	43 (46.2%)	8 (8.6%)	Nil	93 (100%)
17	Buy stock which is expected to announce bonus issue and/or stock split.	32 (34.4%)	44 (47.3%)	17 (18.3%)	Nil	93 (100%)
18	Buy stock which is most actively traded.	27 (29%)	40 (43%)	17 (18.3%)	9 (9.7%)	93 (100%)
19	Buy stock which has announced good quarterly results.	27 (29%)	35 (37.6%)	31 (33.3%)	Nil	93 (100%)
20	Buy stocks on the basis of 30 days moving average.	25 (26.9)	32 (34.4%)	36 (38.7%)	Nil	93 (100%)
21	Buy stocks on the basis of Relative Strength Index.	17 (18.3%)	27 (29%)	41 (44.1%)	8 (8.6%)	93 (100%)

ORDER OF PREFERENCE OR RANKING OF VARIOUS INVESTMENT STRATEGIES IN INDIAN EQUITY MARKET

The above findings have been further analyzed so as to find out which the best cited investment strategy is in the Indian context and what has been the ranking of all these investment strategies. For this purpose, mean scores have been calculated using Likert-scale. The following numbers have been assigned to different ratings provided by the respondents :

Very well = 4, Well = 3, Somewhat = 2, Not at all = 1

Table 4 shows the mean scores of the respective investment strategies in descending order. It can be observed from the results that five most preferred investment strategies as perceived by the respondents are :

(1) Buy stock for which good news is expected (Mean Score 3.36).

(2) Buy stock which is expected to announce bonus issue and/or stock split (Mean Score 3.161).

(3) At the third place, there has been a tie between momentum strategy and size based strategy (both have mean score of 3.086).

(4) Buy stock which has announced good quarterly result (Mean score 2.957).

(5) Buy stock which is most actively traded (Mean Score 2.914).

As far as the company fundamentals based investment strategies are concerned, the following observations have been made.

(1) First place is occupied by size based investment strategy (Mean Score 3.086).

(2) Second place is occupied by P/E effect (or buy low P/E stocks) based strategy (Mean Score 2.344).

(3) At the third place, we found leverage based investment strategy (Mean Score 2.107).

(4) Value based investment strategy is least desirable among the respondents in comparison to other fundamentals based investment strategies (Mean Score 1.914).

The least preferred investment strategies in Indian Stock Market are January Seasonality Strategy (Mean Score 1.892), intra month effect based strategy (Mean Score 1.698) and Day of the Week effect based strategy (Mean Score 1.344).

Table 4 : Mean Scores of Investment Strategies Showing How Well They Work In the Indian Stock Market

Strategy	Mean Score
Buy stock for which good news is expected.	3.3656
Buy stock which is expected to announce bonus issue and/or stock split.	3.1613

Momentum effect (but past winners).	3.0860
Size effect (buy small cap stocks).	3.0860
Buy stock which has announced good quarterly results.	2.9570
Buy stock which is most actively traded.	2.9140
Follow the investment behaviour of FIIs.	2.9032
Buy stocks on the basis of 30 days moving average.	2.8817
Buy stock whose price has gone up by 20%.	2.6559
Buy stocks whose price has crossed a 52 week high.	2.6237
Buy stocks on the basis of Relative Strength Index.	2.5699
Contrarian effect (buy past losers).	2.4516
P/E effect (buy low P/E stocks).	2.3441
Pre Holiday effect.	2.2151
Buy stocks whose price has gone down by 20%.	2.1505
Leverage effect (buy stocks of highly levered companies).	2.1075
April effect (buy stocks in March and sell in April).	2.0430
Value effect (buy high Book to market equity stocks).	1.9140
January Seasonality effect (buy stocks in December and sell in January).	1.8925
Day of the week effect (buy Monday sell Friday).	1.6989

INVESTMENT STRATEGIES RECOMMENDED AND/OR USED BY INVESTORS IN INDIAN EQUITY MARKET

In order to investigate as to what are the popular investment strategies being recommended and/or used by equity analysts, mutual fund managers and active investors in Indian equity market, the researcher asked the respondents how often do they use these strategies and to rate the specified investment strategies on a three point scale as 'mostly', 'sometimes' and 'not at all'. Fifteen such strategies have been specified clearly in the questionnaire and information has also been sought as to the other investment strategies which might have been used by the respondent. The results have been presented in Table 5. In order to present meaningful analysis of the collected information, we have calculated mean scores of these investment strategies using Likert-Scale and assigning the following numbers for different rates. Mostly = 3, Somewhat = 2, Not at all = 1

Then these strategies have been ranked on the basis of their mean scores (from highest to lowest). Table 6 presents the results regarding mean scores of various investment strategies used and/or recommended by equity analysts, fund managers and active investors in the Indian equity market. The results clearly show that five mostly used investment strategies in Indian equity market are :

(1) Size based strategy (Mean Score 2.323).
(2) Momentum strategy (Mean Score 2.290).
(3) Following the investment behaviour of FIIs (Mean Score 2.226).
(4) Buying stocks on the basis of 30 days moving average (Mean Score 2.096).
(5) Buying stocks on the basis of Relative Strength Index (Mean Score 2.053).

The least used/preferred investment strategies have been intra month effect (Mean Score 1.425 and Day of the week effect (Mean Score 1.225).

Table 5 : Investment Strategies Recommended / Used By Investors In The Indian Stock Market

S. No.	Effect(Investment strategy)	Most of the times	Sometimes	Not at all	Total
1	Size effect (buy small cap stocks).	35 (37.6%)	53 (57%)	5 (5.4%)	93 (100%)
2	Value effect (buy high Book to market equity stocks).	13 (14%)	44 (47.3%)	36 (38.7%)	93 (100%)
3	Leverage effect(buy stocks of highly levered companies).	43 (46.2%)	Nil	50 (53.8%)	93 (100%)

4	P/E effect (buy low P/E stocks).	25 (26.9%)	43 (46.2%)	25 (26.9%)	93 (100%)
5	January Seasonality effect (buy stocks in December and sell in January).	1 (1.1%)	48 (51.6%)	44 (47.3%)	93 (100%)
6	April effect (buy stocks in March and sell in April).	8 (8.6%)	33 (35.5%)	52 (55.9%)	93 (100%)
7	Day of the week effect (buy Monday sell Friday).	Nil	21 (22.6%)	72 (77.4%)	93 (100%)
8	Intra month effect.	6 (6.5%)	25 (26.9%)	62 (66.6%)	93 (100%)
9	Pre holiday effect.	7 (7.5%)	31 (33.3%)	55 (59.1%)	93 (100%)
10	Momentum effect (buy past winners).	35 (37.6%)	50 (53.8%)	8 (8.6%)	93 (100%)
11	Contrarian effect(buy past losers).	8 (8.6%)	61 (65.6%)	24 (25.8%)	93 (100%)
12	Follow the investment behavior of FIIs.	35 (37.6%)	44 (47.3%)	14 (15.1%)	93 (100%)
13	Buy stocks whose price has crossed a 52 week high.	8 (8.6%)	54 (58.1%)	31 (33.3%)	93 (100%)
14	Buy stocks on the basis of 30 days moving average.	40 (43%)	22 (23.7%)	31 (33.3%)	93 (100%)
15	Buy stocks on the basis of Relative Strength Index.	35 (37.6%)	38 (30.1%)	30 (32.3%)	93 (100%)

Table 6 : Mean Scores of Investment Strategies As To How Often Respondents Use Them.

Strategy	Mean Score
Size effect (buy small cap stocks).	2.3226
Momentum effect (buy past winners).	2.290
Follow the investment behavior of FIIs.	2.2258
Buy stocks on the basis of 30 days moving average.	2.0968
Buy stocks on the basis of Relative Strength Index.	2.0538
P/E effect (buy low P/E stocks).	2.0000
Contrarian effect (buy past losers).	1.8280
Value effect (buy high Book to market equity stocks).	1.7527
Buy stock whose price has crossed a 52 week high.	1.7527
January Seasonality effect (buy stocks in December and sell in January).	1.5376
April effect (buy stocks in March and sell in April).	1.5269
Pre Holiday effect.	1.4839
Leverage effect (buy stocks of highly levered companies).	1.4624
Intra month effect (buy Monday sell Friday).	1.4253
Day of the week effect.	1.2258

CONCLUSION

The survey results presented in this paper show that most of the investors use both fundamental as well as technical analysis while investing in the Indian stock market. The investors strongly agree that various company fundamentals significantly influence stock prices in India. Majority of the respondents agree that other factors such as size, book to market equity, leverage and P/E ratio can better explain cross sectional variations in equity returns in India. Most of the respondents agree that arbitrage opportunities are available in the Indian stock market. Five most worthy investment strategies in Indian stock market (as perceived by respondents) are buying stocks for which some good news is expected, buying stocks which are expected to announce bonus issue, momentum strategy, size strategy and following investment behaviour of FIIs. Five most widely used investment strategies in Indian equity market are size based strategies, momentum strategies, following FIIs investment behaviour, buying stocks on the basis of 30 days moving average and buying stocks on the basis of relative strength index. There has been substantial change in investment strategies used by active investors in Indian stock market over the past five years. In a nutshell, there has been a shift from purely technical analysis based strategies to the one which involves both fundamental and technical analysis. Moreover, the investment horizon of investors has also reduced due to higher volatility.

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