Invest in stock market wisely

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The stock market as an investment avenue is as exciting as it is risky. Again, with the market composition being a complex mix of small-, mid- and large-cap stocks, the investment avenue is certainly not easy to crack.

Choosing the right stock in terms of its market capitalisation is hardly a decision that is easy to make. Market capitalisation can be simplistically understood as the value of the stock that you derive by multiplying the stock price by the company's outstanding number of equity shares.

Market correction in large-cap stocks, and mid-cap and small-cap stocks doing well have been a recent trend seen over the past two years.

However, this is a trend that is temporary and cannot be relied on to make the right decisions. What sells today might not sell tomorrow and stock market dynamics are similar.

Small- and mid-cap stocks are more risky in comparison to large-cap stocks as the former are not well researched. On the other, good small- and mid-cap stocks if identified right, can be a winner and have the potential to morph into large-caps.

So, what is it that works in terms of selecting stock based on the market cap? Well getting to the fundamentals, a good start would be to look at the management quality of small- and mid-cap stocks including the business ethics and strong business fundamentals to help the company transcend to the next level.

Also choosing companies with low/no debt is favourable for small- and mid-cap companies, as high debt implies a huge interest outflow that will have a negative impact on the company's performance.

Blue chip companies

Also with large-cap stocks, we typically think of blue chip companies that have a traditional long-term focus. Keep the portfolio active with continuous monitoring and remove stocks that do not perform as per the expectation, and add stocks that have the potential to be winners.

Again, investments are usually almost guided by the investor's ability to take risks and equity, and this will determine the investment allocation among small-, mid- and large-caps. While large-cap stocks are perceived to be less risky, the small- and mid-stock caps are riskier.

However, when the economy is on a rebound, the small- and mid-cap stocks see faster recovery. Analysts opine that you must invest in funds with a lower turnover ratio, lesser than 0.5 and those which have performed through various cycles.

In fact, equity is a volatile asset class and the only way you can manage this volatility is to increase the time horizon. The key is to identify prudently-managed mid-cap funds as they can give you consistent results over the long-term. In the next 4-5 years, the market is expecting 15% plus earnings growth and investors who are able to take the right call are sure to be the winners.

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