EXIT STRATEGIES OF INVESTORS:

PURPOSE: The paper explains the importance of deciding on the time of "exit" in reducing shareholder's losses or risk exposures and maximize his profits .

METHODOLOGY USED: The paper descriptively explains the various strategies used in timing the exit. Various research articles are inferred in preparing this paper.

SHAREHOLDER:

A Shareholder can be an:

- Investor
- Speculator

The exit strategy of the two categories of shareholders differ because of their different approaches of expecting returns.

UNDERSTANDING INVESTOR'S AND SPECULATOR'S RETURN:

Investors measure the profitability of their investments based on the firm value or market capitalization rate, therefore a higher market capitalization rate implies higher profitability and vice versa

Speculators measure the profitability based on the market price fluctuations,that is they gauge the effectiveness of their investments based on market share price appreciation.

Speculator's look for market price appreciation and investors give importance increases in market capitalization rate, after a through analysis of firm valuation. Therefore we can conclude that speculators look for short term price fluctuations and investors look for long term profitability of their investment.

Here market capitalization can be worked out using the following formula:

Market capitalization rate =Share price*number of shares outstanding.

A speculator buys shares when share price falls (expecting the price to rise in the near future) and he sells the shares when there is a price appreciation above his purchase price thereby making a profit on the price differential. An investor sells his investment when the market price is overvalued and buys the share when the market price is undervalued.

Example. The market price fluctuation of Bawmel lawrie is given below:

Date	Closing price(NSE) 2009	#Price fluc.
25-Mar	235.74	NA
26-Mar	240.65	5
27-Mar	238.05	-2
28-Mar	235.75	3
29-Mar	240.65	5
30-Mar	238.05	-2

31-Mar	235.15	3
1-Apr	237.00	2
2-Apr	232.15	-5
3-Apr	229.20	-3
4-Apr	245.30	16
5-Apr	251.00	6
6-Apr	259.00	8

Source:moneycontrol.com

#Price fluc.-Increase/decrease between consecutive Periods: 25th march onwards (in order) =approximate values

The price has reached the highest on 6th April at Rs.259 therefore using this table a speculator would sell his investments at Rs.259.Assuming he has purchased his share at an earlier date(lower than Rs.259).

An investor would on the other hand, calculate the intrinsic value of the firm based on the firm's earning potential (future) and make an investment decision, the firm's intrinsic value can be measured through earnings per share.

Therefore, wild price fluctuations would occur far less frequently because as soon as a security appeared to be undervalued, investors would buy it, driving the price up to more reasonable levels. When a company became overpriced, it would promptly be sold.

INVESTOR EXIT STRATEGIES:

PORTFOLIO DIVERSIFICATION:

Portfolio refers to a collection of investments in various stocks, management of the right mix of portfolio is crucial to an investors success in earning profits. To earn maximum profits the investor has to maintain a well diversified portfolio. If an investor's portfolio comprise of investments in similar industries then he is exposed to risks to a large extent, therefore the right choice is to balance with investments from varied industries and have a mix of high risk (high profit earning) shares and low risk (low profit earning)shares.The benefits of portfolio diversification is illustrated below:

TABLE 1:

Profit on investment in:(Rs)

Investment type	Year1	Year2	Year3	Year4	Year5
Government Bonds	1000	1000	1000	1000	1000
Preference shares	1000	1200	1300	1000	1200
Equity shares	200	1000	300	100	0
TOTAL	2200	3200	2600	2100	2200

AVERAGE:Rs.2460

The above table shows a well diversified portfolio, where investors risk spread is reduced where the loss of one type of asset is hedged to the profits of other assets.

TABLE 2:

Profit on investment in:(Rs)

Investment type	Year1	Year2	Year3	Year4	Year5
Equity shares#	2000	1000	500	0	30
Equity shares#	1000	1200	200	50	20
Equity shares#	200	500	300	30	40
TOTAL	3200	2700	1000	80	90

Average:Rs.1414

#Equity shares of companies belonging to the same industry

The table given below shows poor portfolio management , the table below shows volatile cash flows ,thereby making investor face higher risk exposures.

Thus we understand a rational investor always strives to achieve a balance between high risk and low risk investments, thus if an asset class becomes homogenous then an investor sells those assets to create a heterogeneous mix.

INVESTOR EXIT STRATEGIES:

RED FLAGS:

Identifying "red flags" involves in analyzing company financial statements, it measures a company's value through its performance(profitability), competitive advantages, competitors, markets, economic development (interest rates, savings, investments, income). It deals with selling the shares (irrespective of current price of a share to minimize losses) when the company's fundamentals are deteriorating or when one expects the company to face losses in near future.

An investor measures his profit position under various scenarios and tries to optimize his investment position under each of these scenarios.

Creating simulations:

A "simulation" is defined as an impact created by altering various factors and measuring share price variations due to these factors or levers. Given below is a simulation exercise:

Source:www.hiddenlever.com

Levers Price Increase Share Effect Decrease Share effect
Oil price Rs.50 10%
Airline industry 3%, oil and natural gas 4% 10%
Airline industry 5%
CPI Index 543(base100) 15%
Real estate 5%, consumer durables8% 15% Real estate 7%

Best performing companies: Worst performing companies:
ONGC,Jetairways
DLF,Appaswamy real estate ONGC, Jetairways
DLF,Appaswamy real estate

SPECULATOR EXIT STRATEGIES:

PERCENTAGE OF SHORT INTEREST:

To sell a stock short, the shareholder's borrow the shares from a broker, then sell the shares and hold the money and wait for the stock to fall. If it does, he buys the shares at a lower price and gives them back to the broker, who gets a commission and interest for his or her risk participation. The shareholder makes a profit through this process.

$$\% \text{ short interest} = \frac{\text{Number of shares sold short}}{\text{Total number of shares}} \times 100$$

The higher the percentage short, greater the risk. For example. A speculator borrows 200 DLF shares for Rs.333.45 and sells it immediately expects it to fall Rs.328 when it falls to this level he buys it at 328 and gives them back to the broker after deducting his profit of Rs.5.45*200=Rs.1090(profit),his net profit arrived at after deducting brokerage and commission for broker's risk. In shorting process the speculator would make profit only in a bearish market and incur loss in a bullish market. High percentage of short interest implies share fall perception among speculators and vice versa.

Jos.A.Bank clothiers Inc.

Market price ($)	Short interest	Prior short	Increase
59.9	14.40%	18%	3.41%
59.2	15%	14.40%	0.60%
60.6	16%	15%	1%
61.8	19.45%	16%	3.45%

Source:www.shortsqueeze.com

TREND LINE:

Here the speculator decides an appropriate exit timing through a trend line, this line links all the "peaks"-line of resistance(downward slopingR1,R2), and trend line connecting price lows(upward sloping)-"support line" when the price moves below the support line, shareholder's are to buy the shares because prices below this line indicate their undervaluation and probability of future rise and when prices rise above the line of resistance indicates investors to sell overvalued share.

source:www.bigcharts.com

The speculator sells his stake when the share price rise beyond $32.1,buys when the share price falls below $18.

EXPECTED PERCENTAGE PROFITS/LOSSES:

It depends on how much loss a shareholder expects to bear, percentage on ROI and duration of holding to be profitable. Deciding a stop loss percentage is a challenging task, it requires the shareholder to study the company's historical price charts to arrive at a decided percentage, which would neither close an investor's decision too early causing reduction in profits or keep an investor open to risks for longer periods causing increased losses.

Source:www.bigcharts.com

Percentage fixed for A would be higher than B or C, if investor fixes B'or C' percentage stop loss for A then A would achieve this percentage earlier leading investor to sell soon, thereby reducing his profit margin.

A shareholder can maximize his profit and mitigate his losses by deciding the right time to exit.

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