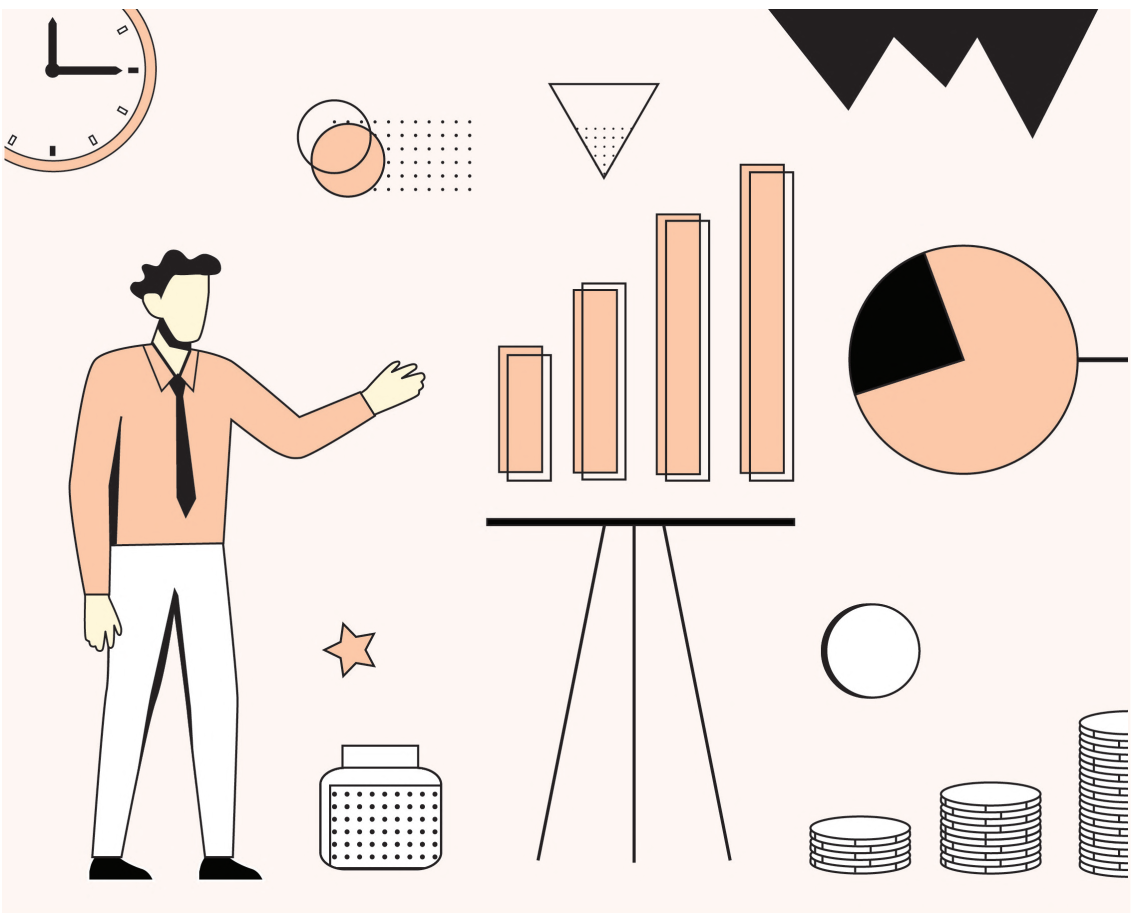
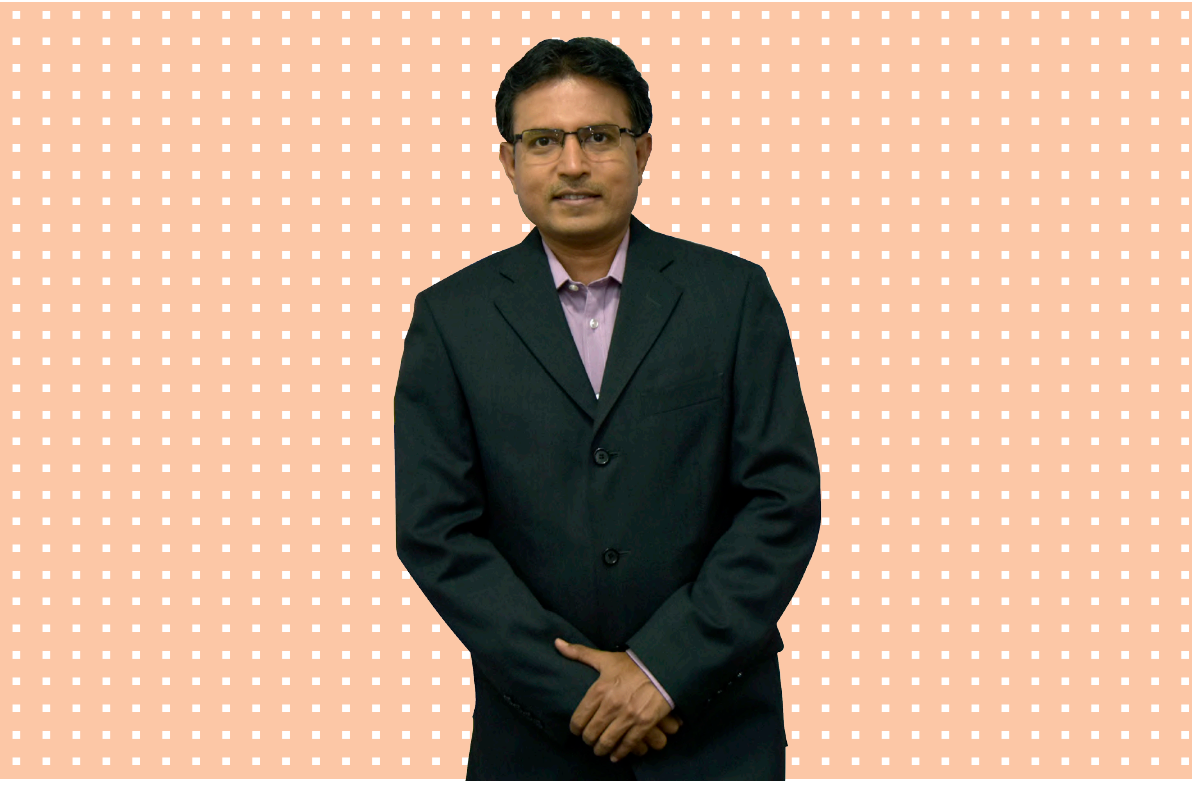
Value Research

MY MOST PRECIOUS INVESTING LESSONS

SERIES 2

Eight veterans of the mutual fund industry share their investing lessons, mistakes and anecdotes to help you become a smart investor





NILESH SHAH, Group President and MD, Kotak Mahindra AMC

'Discipline and patience are the biggest differentiator'

I did my articleship at Hamam Street, behind the BSE Tower, three decades back. I was attracted to the stock markets, like my colleagues, to make quick money. In those days, the stock market was the Wild West, with terms like 'company circle buying', '*vandho*' (dispute), 'payment crisis', '*galo*' (gap/difference), '*patavat*' (settlement), 'bad delivery', etc. Might was right. Bulls and bears were making money and retail investors like me were getting slaughtered.

Luck guided me to an old sub-broker wearing traditional *dagla* (overcoat). I am happy to narrate his advice, in native Gujarati, which has helped me immensely over the years in managing money.

- While we do Laxmi *Pujan* on Dalal Street every Diwali, you need to worship Sarasvati *Maa* every day. Knowledge and wisdom are critical to making money in the stock market.
- Investment is about common sense, which is not so commonly available. You don't need to wear tie and suit (professional degree) to make money. *Dhoti-dagla* (knowledge and wisdom) is sufficient.

- Other than your parents, no one else is interested in making you rich. Listen to all, but make your own decisions. Don't blindly follow the tips.
- *Teji–mandi* (bull and bear) is like *Poonam* and *Amas* (full moon and new moon), albeit without any fixed pattern. In the darkness of *Amas*, always think of *Poonam*.
- Trading is a very difficult way to make money. Investment is an easy way to make money. In trading, stop loss is critical. In investment, averaging is critical. In trading, discipline is critical. In investment, patience is critical. A trader has to be fast. An investor has to be slow and steady. Remember one can make mistakes when in hurry and avoid when steady (*Utavala so bavla, dhira so gambhir*)
- When *batata* (low-quality stocks) trades at a premium over Tata (quality stocks), it is time to get out of the market.
- *Bhav bhagwan* – price will reflect most known things. Don't bet against the market. Dalal Street is paved with the *paliya* (gravestone) of people who believed that they knew more than the market.
- Be humble. Don't have ego/overconfidence as even Lord Ravan lost Golden Lanka due to his ego. (*Abhimaan to Raja Ravan nu pan nahi takyu*).
- Invest in quality. You don't take *vasi* (old) samosa of Dwarka (a famous restaurant on the corner of Dalal Street) home. Why take a *kachra* stock home? Quality never comes cheap.
- If making money was so easy, everyone would have been rich. You have to work hard and be patient to make money.
- Greed has no limit (*lobh no thobh nahi*).
- Don't get carried away by money and fame. On Dalal Street, when you have money and power, you are known as Sheth Nathalal. When you don't have money and power you will be called nathiyo. (*Nana vagar no nathiyo, Nane Nathalal*).

As an investor my duty is to do good karma and leave it to the market to reward. As in God's world, in the market also you may have to wait but there is justice.

His wisdom accumulated over decades is reflected in the teachings of many legendary investors.

Dalal Street is where dreams are made and destroyed. The biggest learning from three decades of participation in market is that discipline and patience are the biggest differentiator between success and failure on Dalal Street.

As I enter my *Vanprastha ashram*, I have started believing that as an investor my duty is to do good karma (invest in good companies run by good managers coming from the conviction of good research) and leave it to the market to reward. As in God's world, in the market also you may have to wait but there is justice. (*der hai per andher nahi hai*).

MANISH SONTHALIA
Director & CIO, PMS, Alternates & Offshore, Motilal Oswal AMC

'Vision to see, courage to buy and patience to hold'

Investing is all about the 'vision to see, courage to buy and patience to hold'. It all sounds very simple but is in fact very difficult to practise. 'Vision to see' implies seeing the future, which is always hazy and difficult to predict. 'Courage to buy' implies in a way fighting the markets as more often than not, the markets would cause the stock to move in the opposite direction in the short to medium term. 'Patience to hold' is most difficult to practise after you have got the stock right and have had the courage to buy. It is the temperament to hold which in itself has to be cultivated from within, practised and imbibed. This does not come suddenly but only with experience. The urge to not trade or flip is very difficult to practise as the limiting factor in investment is always the capital and not the ideas.

Businesses don't travel in a straight line. Even very good businesses go through ups and downs. One would do well to not sell good businesses in bad times because 'tough times don't last long, but tough people do'. In the world of investing, only those businesses that have survived for a long period of time have the best chance to survive or grow longer in the future. This is called the 'Lindy effect' in the corporate world. This is particularly more relevant in the world of disruptions and disruptive innovations that we are in now. I held Pidilite Industries for a long period, made decent returns on the stock. However, after two quarters in a row, the company disappointed on margins due to very high VAM prices (vinyl acetate monomer, one of the key raw material for the company). I sold the stock. The stock went on to become 10x from there.

In the world of genuine investing and not momentum investing, one is always going to be alone with his/her idea, with not many supporters to back one's thesis to own that stock. There will always be detractors to your idea and one will have to stick to one's conviction to ultimately create wealth from that stock. Real investing is really very boring. If one requires thrill, one would be better going off to a casino.

There is nothing called a high price or a low price in the markets; it's always relative in context. A high price can go higher and a low price can ultimately go down to zero.

There is nothing called a high price or a low price in the markets; it's always relative in context. A high price can go higher and a low price can ultimately go down to zero. Markets can remain irrational longer than you can remain solvent. However, having said that, markets are mostly efficient. I still have Page Industries in my portfolio even after the stock has become a multibagger. A high stock price continues to become an even higher stock price.

There is nothing called borrowed conviction. If one listens and acts on advisors or analyst recommendations, it would never help. Self-confidence comes from understanding the company, its underlying business, its value-creation process. If one genuinely understands these traits, can one train one's own mind to practise patience to hold that stock in adverse times. Markets are an expert to cause emotions to throw you out of your conviction. One has to hold onto one's conviction against market moods to get it right. One principle in life which has always worked to my benefit not only in the world of investing but also in all walks of life: 'If you don't understand something, don't do it'. If one does something which one genuinely does not understand or believe in, he or she will have nobody to blame for it except himself/herself.

There is nothing called borrowed conviction... Self-confidence comes from understanding the company, its underlying business, its value-creation process.

'Investing' and being in the 'business of investing' are two different things. 'Investing' is to create bigger and better purchasing power in the future by sacrificing the current purchasing power. When one is in the 'business of investing', one carries the fiduciary responsibility of being better than the benchmark or peers. In the business of investing, it's a relative-return game. In the real world of investing, it's always an absolute-return game.

In today's world, the valuation metric of price-earnings (P/E) multiple has just got reduced to it being a number. Why? Because, good businesses are always rare to find in the real world and when the stock market recognises some of these, nobody wants to sell them. Hence, the P/E multiple becomes redundant. P/Es become a function of the terminal value, which continues to rise for a very long period of time. As long as the investment thesis holds well, one should hold onto the stock. I had

Bajaj Finance in my portfolio. It was a multibagger stock in the portfolio. The underlying thesis always remained good; the valuations became expensive. It doubled even from there.

One of the most difficult questions to practise in long-term investing is 'when to sell?' The buy-and-hold approach to investing can give rise to complacency. One has to train one's mind to not be complacent. If business models get broken due to Michael Porter's Five Forces model, thereby not allowing the company to achieve a particular desired growth rate, or there is a visible and understood corporate-governance issues that have cropped up within the company, to my mind it's game over for that stock.

Although the list of lessons that one can learn in investing is countless and is an everyday event, if one can practise some of the above, he/she can become a better investor.

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RAJEEV THAKKAR, CIO, PPFAS Mutual Fund

'Odds are in favour of investing in the wealth-creating sectors'

As a young adult who joined the financial markets in 1994, there have been numerous lessons along the way.

Do not leverage while investing

The first lesson which came relatively quickly was the damaging effect of leverage. The company that I worked for recruited from among the brightest people around. Many of them are still considered among the best in the investing field. However, the company used leverage in its equity investments and was on the verge of bankruptcy very soon. It does not matter how good an investment thesis is if there is no capacity to hold the investment through volatile times. One will have to sell the investment on account of margin calls of the broker or the banker/ lender forcing a sale.

Do not trust easily

As a fresher, I was an intern in the investment-banking division and was helping with the preparation of offer documents for IPOs and so on. When I look back, I realise that many of the companies from those times are not even around today. Of course, the IPO market today is far better than the one that existed decades before. However, it is important to see the behaviour of a newly listed company over a few years before deciding to invest in it as many of these companies are otherwise unknown. This of course does not apply to IPOs from well-established business houses or public-sector companies.

Investors seeking to succeed in the field of investing would do well to look at the history of the management and the sector apart from only the financial parameters

Quality of the promoters/ management matters

Among various companies starting almost at the same time in the same sector, there are a handful that became very successful, while the vast majority of the companies fell by the wayside. The companies uniformly had the same economic cycles, policy and regulations, competitive intensity and so on. The major factor that differentiated the winners from the losers was the management. Sometimes it is difficult to distinguish good management from the bad but most times it is fairly obvious. Straying away from good management usually gets penalised sooner rather than later.

Quality of business matters

The same business house may be extremely successful in one business, while it may be a dismal failure in some other business. Many times, it is on account of the nature of the business. You will find multiple entrepreneurs failing in a sector (wealth-destroying sectors) and multiple entrepreneurs succeeding in some other sectors (wealth-creating sectors). For example, most listed FMCG companies have delivered decent returns for shareholders while most listed airlines have lost money for shareholders. There are surely exceptions to this but the odds are in favour of investing in the wealth-creating sectors.

Investors seeking to succeed in the field of investing would do well to look at the history of the management and the sector apart from only the financial parameters.

Happy investing!

MANISH GUNWANI, CIO – Equity Investments, Nippon India Mutual Fund

'It is important to see investing as a journey to be enjoyed'

As in life, in investing I have found that immense wisdom can be gained from the quotes of Dumbledore from the Harry Potter series. Here are my thoughts around four of the best quotes on how they apply to investing:

It is our choices that show what we truly are, far more than our abilities

In my experience the biggest mistakes are made not because of wrong analysis but due to 'the noise in the head' from emotions, incentives, etc., which are actually choices we make all the time. One of my biggest learning came in 2007. I was on the sell side covering real estate and all the data was saying stocks were massively overvalued but there was so much liquidity, fund raising, etc., that I got carried away and missed calling the peak.

There will be a time when we must choose between what is easy and what is right

Most great investment decisions are never easy as they go against popular thinking. While most times, this applies to stocks which have fallen out of favour and are cheap on numbers but sometimes it is true also of buying stocks which are expensive on traditional metrics but from a different perspective (market cap, EV/sales, etc.) can be very attractive. In 2010-11, for instance, Britannia was expensive on earnings but the enterprise value was broadly equal to sales, which turned out to be the more relevant metric as the stock became a multi-bagger over the next few years.

You will find that help will always be given to those who ask for it

My view is that as economies develop, the complexity of stock markets keeps rising as more sectors come to the fore and the role of intangibles (brands, R&D, etc.) becomes more important.

In 2010-11, Britannia was expensive on earnings but the enterprise value was broadly equal to sales, which turned out to be the more relevant metric as the stock became a multi-bagger over the next few years

This implies that investors have to be humble enough to recognise that it is very difficult to digest information on their own and build a support system around themselves. Globally, in asset managers, teamwork seems to be getting more important than superstar fund managers.

It does not do to dwell on dreams and forget to live

I think it is important to see investing as a journey to be enjoyed and to enrich your life rather than obsess over its results. The happiest investors I have met are those who combine a burning passion for the art with a sense of detachment to the actual money that is made from it.

VINAY PAHARIA, CIO, Union AMC

'Investing is not a part-time hobby or a get-rich-quick scheme'

Stock markets are a temple of learning for a capitalist. A person can spend a lifetime in markets and keep learning something new every time. I have tried to summarise some of my learnings in the stock markets over the past two decades in the following paragraphs.

Equities are growing annuities to perpetuity

While theory is clear about this, most market participants tend to confuse this simple fact. In my opinion, stock prices constantly discount cash flows to perpetuity and hence if any event occurs which impacts the business even in distant future, it shall be discounted immediately.

Quality (of business and management) matters

I have learnt it by paying some 'tuition fees' that quality of business is of significant importance in terms of long-term investment performance. Good-quality companies have delivered strong performance compared with weak-quality ones over a fairly long period of time. Quality means the ability of a business to earn substantially higher returns on capital over its cost of capital, throughout its lifetime. This can be achieved if a business enjoys some material competitive advantages over its peers.

Low P/E means cheap and vice-versa

Stock P/E multiple depends on four factors, viz., (1) sustainable earnings growth, (2) sustainable return on equity (ROE), (3) riskiness of business, and (4) risk-free rate of return in the country. Thus, some companies may be trading at a low P/E because either their potential future growth is low or their return on equity is poor or both. The reverse may be true for companies trading at higher P/Es. Hence, investors should not make investment decisions purely based on headline valuations.

Growth without adequate ROE is bad

Not all growth is good. Some companies are growing fast by consuming higher proportion of capital, which is bad growth. Market only rewards companies which are growing at a fast pace while maintaining returns on incremental capital employed higher than their cost of capital.

A high ROE without growth is not good either

Just like growth without an adequate ROE is bad, similarly companies enjoying high ROEs but having limited opportunities for growth would be rated low by the markets. Many companies which used to enjoy good ROEs in the past but are facing disruption in their businesses fall in this category.

Crowd behaviour is the same everywhere and every time

Behaviour of investing crowd has remained the same for centuries and across continents. Crowd is always subject to vicissitudes of greed and fear produced by markets from time to time. This is the reason behavioural investing is gaining popularity amongst investors.

Investing is boring – any attempt to make it otherwise impacts performance

Investing is not a part-time hobby or a get-rich-quick scheme. Investing is an act of allocating capital today in expectation of getting a return or profit on the same, along with getting back the original capital, over a longer period of time. Any attempt to make it exciting by trading in and out of securities or speculating can impact an investor's eventual performance adversely.

Cutting flowers to plant weeds

This is the most popular mistake made by investors. It's a general investor tendency to sell companies which have delivered good returns in the name of 'booking profit' and use the proceeds to buy companies which have delivered poor returns. As someone has said, you can never go broke taking a profit. On the flip side, you can never become rich by taking small profits when multi-bagger returns are possible. Good-quality companies with superior growth prospects are hard to find and hence, investors should look at a business's long-term potential before making changes to the portfolio.

As someone has said, you can never go broke taking a profit. On the flip side, you can never become rich by taking small profits when multi-bagger returns are possible.

VINIT SAMBRE, Head – Equities, DSP Mutual Fund

'Patience is a rare commodity in our markets'

Even after spending over two decades in the markets, I still feel like it is Day 1 in the market in terms of opportunities to learn. Let me share my important learnings which have helped me in my career.

Patience is the biggest virtue

I feel patience is a rare commodity in our markets and something which is rare is precious. With so much data available nowadays, there is a race to process every piece of information very quickly to remain ahead of the curve. However, I believe that the value of the company as measured by its business growth, cash flows, ROE, etc., does not change as quickly as the share price does.

We have seen so many times that stock price reacts disproportionately to events such as elections, credit policy, currency movements, etc. However, over time, good businesses have survived and thrived amid all major and minor events. In my career spanning 23 years, I have seen companies surviving the onslaught of major events like the dot-com bust, Lehman crisis, taper tantrum, high interest rates of 13-14 per cent, and now the pandemic. Not to say that these factors do not affect the companies, but in the long cycles, these turn out to be momentary blips. Disproportionate reaction to such events creates wide disparity between the value of business and the price.

Our long-term approach has allowed us to use these temporary disruptions to our advantage by playing the contrarian role. My experience has been that once we have identified a good company run by a capable management, the maximum wealth has been created by staying invested in these companies for long through their good and bad patches. We have faced challenges of underperformance in many of our investee companies during their low cycle. However, our long-term philosophy has not deterred us from staying the course and sustaining the pain for a short period. As an example, our investment in specialty chemical back in 2012-13 hurt us during the raging bull market of 2017. However, we stayed the course and gained significantly during the period thereafter.

> Businesses with sector-leading growth and superior ROEs (much higher than the cost of capital) are the two important factors which drive long-term wealth creation

Look for positive management change

I have seen many businesses turning around after having seen a good management change. Many companies where positive management change took place have created a lot of value due to appropriate strategies being put in place and effective execution of the same. As an example, the largest listed biscuit manufacturer saw significant rerating since 2013 with the top management change.

Capital allocation

Businesses with sector-leading growth and superior ROEs (much higher than the cost of capital) are the two important factors which drive long-term wealth creation. Any company's capital-allocation decision determines whether the business will continue to deliver on the above metrics and hence needs to be monitored closely. Capital misallocation is one of key reason for business failure and poor return.

Focus on history rather than predicting the future

I feel predictions have less value, and still most time is spent doing that. I have rather found merit in looking at the long history of the company, which provides a good insight about the company's performance, both in good and bad times. This history has given us confidence to stay invested and double down when businesses go through a bad phase.

JANAKIRAMAN R, VP & Portfolio Manager, Emerging Markets Equity - India, Franklin Templeton

'Long-term trends play an influential role in equity returns'

A key realisation is that long-term trends play an influential role in equity returns. Examples are India's demographic advantage and a higher level of savings rate. The influence of these trends is well discussed but investors are prone to overlook these powerful factors. What these trends offer you is clarity during times of crisis or uncertainty. The decisions an investor makes during such crisis points have a large bearing on his/her long-term returns. A better appreciation of these long-term trends serves as an anchor and helps an investor avoid expensive mistakes during such uncertain times.

The ability to let winners run for a long time and cut laggards early is an attribute critical in generating strong returns. I do admit that this observation sounds quite theoretical, but this is as important as identifying a good business to invest in. Truly exceptional returns are made by remaining invested in growing businesses for a long time. The converse is also equally important; I have suffered from having hung on to struggling businesses for a long time, at least longer than desirable, in anticipation of an improvement. In this context, a 'fail fast' approach would have spared me a lot of heartburn!

To make things more interesting, investors must realise that such lessons from past investment experiences are not equivalent to scientific truths. These are not immutable theories that work always. For example, the investment conclusions gathered from 2004–2007 might not have worked during 2015–20; and vice versa. Without letting go of a few core principles, investors must be intellectually prepared to experiment with a few different theses for a given situation and be willing to discard a solution that may have worked in a different situation that does not appear effective in this case. This is a difficult skill to develop; I know this since I have been struggling to do so. But this is what makes investing intellectually stimulating, besides monetarily rewarding.

Happy investing!

The ability to let winners run for a long time and cut laggards early is an attribute critical in generating strong returns

JINESH GOPANI, Head – Equity, Axis Mutual Fund

'Respect the market and the prices'

Three precious lessons learned from market and those that I follow everyday are as follows:

Markets are better than any single investor

One should always drill in one's mind that the market is always ahead of any individual's wisdom as it's a culmination of great minds that are at works. So, respect the market and the prices and take them in stride.

Learn from your mistakes and move on and don't repeat the same

The important thing is you learn from your mistakes. Reinvent and refine the investment philosophy without forgetting its ethos.

Making mistakes in the stock markets is inevitable. Everyone is bound to make investing mistakes. You win some, you lose some. But the important thing is you learn from your mistakes. Reinvent and refine the investment philosophy without forgetting its ethos.

Conviction and backing the right management

Identifying a credible business and the right management is a tedious process. It has taken us several years of trial and error to do this.

But if you believe in your process and you identify companies with these two golden attributes, you have found yourself a winner. That's where conviction comes in. You have to back yourself and your process and thereafter invest wholeheartedly to reap the rewards of that process. If your investment thesis or conviction is lacking, you may miss the wealth-creation opportunity.

One insightful thing that comes my mind is never to look at a sector or a company that is difficult to scale and has low entry barriers. Most mistakes are made when one invests in those with a view that one will exit before anyone else.

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