

My most precious investing lessons

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



Raamdeo Agrawal Chairman, Motilal Oswal Financial Services

From ignorance of ignorance to QGLP

My stock-investing journey of over 30 years has been full of learning – from ignorance of ignorance at the start to now my proprietary investing process QGLP (more about this in a bit). I present 10 key lessons here.

1. Avoid leverage

Never borrow to invest in the stock market. Assuming a 1:1 debt–equity, a 50 per cent fall in the market will erode 100 per cent of your net worth and put you out of the game. Avoiding leverage allows you to take the booms and busts of the market in your stride.

2. Have a role model

Till 1994, much of my understanding of equity investing was $EPS \times P/E = \text{Stock price}$. Looking back, I call this ignorance of ignorance. Then in 1994, I came across Warren Buffett's annual letters. From 1995 onwards, I also started attending Berkshire Hathaway's annual general meetings. This transformed my understanding of equity investing. For instance, I slashed my portfolio from 200 stocks to about 15. It pays off significantly to have a role model early in your stock-market journey. You can always improve upon the learning from them, but at least you get a solid start.

3. Power of compounding

The secret to successful stock investing is understanding the power of compounding. Compounding works best over the long term. For instance, a 25 per cent return over 10 years results in an appreciation of 9.3 times. However, the same over 30 years results in an appreciation of 808 times. The number of years held is only three times higher, but the appreciation is 87 times higher.

4. Great, Good, Gruesome

This lesson is from Warren Buffett's 2007 annual letter. All companies can be classified into Great,

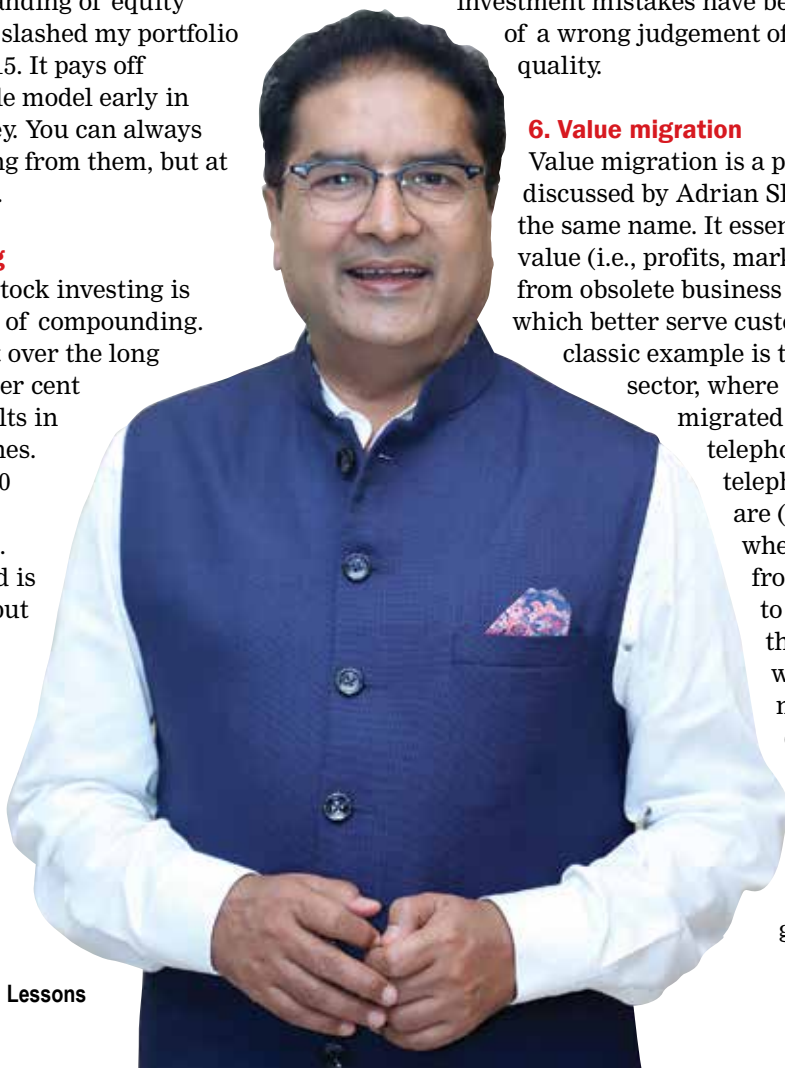
Good and Gruesome. Great companies are those whose return on capital is not only significantly higher than the cost of capital but also rises with every passing year. They require virtually no capital to grow. Good companies are those that earn a return on capital higher than the cost of capital but require significant investments to grow. Gruesome companies earn a return on capital lower than the cost of capital and are compelled to invest more at these lower rates in order to grow. The key lesson is to avoid Gruesome companies at all cost, no matter how cheaply valued they appear to be.

5. Management, the 90% rule of investing

Investment guru Philip Fisher in his book *Path to Wealth through Common Stocks* says, "In equity investing, management is 90%, industry 9% and 1% everything else." I assess quality of management by three criteria: unquestionable integrity, demonstrable competence and growth mindset. In fact, my few investment mistakes have been mainly because of a wrong judgement of management quality.

6. Value migration

Value migration is a powerful concept discussed by Adrian Slywotzky in a book by the same name. It essentially means that value (i.e., profits, market cap) migrates from obsolete business models to new ones, which better serve customer priorities. The classic example is that of the telecom sector, where significant value has migrated from fixed-line telephony to wireless telephony. Other examples are (1) the banking sector, where value is migrating from state-owned banks to private banks and (2) the Indian IT sector, where value has migrated from the developed markets such as US to low-cost countries such as India. Value migration gives its beneficiaries a long growth runway.



7. Growth is a lollapalooza

In equity investing, growth is God. The markets handsomely reward growth in companies' earnings. However, there is a no fixed formula for growth. For instance, it may come through changes in CVPM (cost, volume, price, mix), operating/financial leverage, value migration, regulatory changes, etc. In other words, growth is a lollapalooza, i.e., the result of a variety of factors coming together.

8. QGLP

Every year for the last 24 years, I author the *Motilal Oswal Annual Wealth Creation Study*. Every study discusses a framework, including some of those mentioned above. These studies and frameworks culminated in the form of a proprietary investment process which I call QGLP – Quality (of business and management), Growth (in earnings), Longevity (of Quality and Growth), at reasonable Price. Investors should ideally come up with a time-tested investment process of their own. If not, they are better off investing with fund managers who have a well-articulated investment philosophy or process.

9. India's NTD opportunity

This is a powerful framework to strengthen conviction

If value is higher than the price, then there's a case to buy. If value is lower than the price, then the stock should be avoided.

in the India growth story. It took India 60 years since independence to clock its first trillion dollar of GDP. Post that, every next trillion dollar (NTD) of GDP is coming in at a successively shorter period due to the power of compounding on a higher base. When per capita income rises, consumer spending on necessities does not

increase in the same proportion, leading to a huge growth in discretionary spend, such as on white goods, vehicles, travel, etc.

10. Price is what you pay, value is what you get

It is said that in the stock market, people know the price of everything but the value of nothing. Warren Buffett has made the distinction very clear by saying, "Price is what you pay, value is what you get." Using whatever methodology, investors must independently arrive at the value of companies and juxtapose the same with the price. If value is higher than the price, then there's a case to buy. If value is lower than the price, then the stock should be avoided or sold if already held.

The above are just a few of my key investing lessons. In closing, it can be said that equity markets are getting bigger and more sophisticated by the day. There's enough room for new learning and new masters. You too can be one!

Harsha Upadhyaya CIO - Equity, Kotak Asset Management

'Have the ability to accept mistakes and correct them'

At the outset, let me admit that while I have spent more than two decades in analysing and managing investments, there is always something more and new to learn every day in stock markets. Investing is quite unlike archery or shooting – there is no bullseye or 10/10 here! Even if one achieves a strike rate of six or seven out of 10, it's quite good for investing in the long term. It is also critically important that one should be able to ride winners more than how much you lose due to your investment mistakes. To successfully

manage money over the long term, one needs to have the ability to accept mistakes and correct them.

The following are simple, yet some of the most important lessons or critical factors to manage money, as far as I am concerned:

- Relying on fundamental analysis to choose businesses to invest in
- Diversification of portfolio to manage or minimise risks of investing
- Having patience to live through short-term volatility and noise in stock markets



Mahesh Patil Co-CIO, Aditya Birla Sun Life Mutual Fund

‘Don’t sell your winners too early even as they reach your estimated target price’

During the last 28 years I have been in the markets, I have seen various market cycles, starting with the Harshad Mehta boom (while I was in a management school). Every cycle is a learning experience and teaches something new, shaping one’s investment philosophy and style. Some of these lessons are:

- Don’t sell your winners too early even as they reach your estimated target price. Great companies continue to deliver year after year and can surprise you as they gain more efficiencies and scale benefits. Patience is key here and continuous re-evaluation of the new data is important.
- Devote enough time to get the narrative about the company right while building its investment thesis, rather than focusing only on valuations. The narrative could be the opportunity size, key competitive advantage, etc. This approach is particularly relevant while evaluating high growth and expensive stocks. I have been able to invest in some early-stage growth companies with this approach, which I would have otherwise avoided because of high valuations.
- Take advice from others but invest based only on your conviction because that is what will give you the confidence to hold onto your investment when the company is going through a temporary rough patch.
- Keep an open mind and be willing to accept your mistake early on and move ahead. Carrying the baggage can be a huge opportunity cost. Personal biases can be a big impediment here and to overcome them one should keep on continuously questioning the underperformers objectively.
- Never rely on one valuation parameter to base your decision.

A combination of P&L, balance sheet, cash flow and asset valuations should be looked at to overcome pitfalls of smart accounting. Focus more on cash flows rather than profits.

- As the size of the fund becomes large, portfolio risk management becomes very important. Watch out for large sector concentrations, especially when a sector has outperformed for an extended period of time because such a sector tends to mean-revert. Remember the tech sector in 2000.
- Design a framework for assessing the management capability and quality and integrate it in the investment process. Betting on the right management is the key for long-term wealth creation. A lousy management can ruin even a good business and destroy value for minority shareholders.

In my investment journey there are some interesting lessons which moulded my investment philosophy. For example, when I first identified an NBFC, the company had emerged from a chequered past and was reinventing itself as a technology-driven NBFC with a robust risk-management framework. It was an easy decision at that point in time once the big picture was in place as valuations were reasonable.

Over a period of time, the company became a gold standard in the industry and grew rapidly. It was a big multi-bagger (the stock rose 30 times in seven years) and the valuation multiples kept on expanding. I partially booked profits and started trimming the stock at every rise as the multiples



went beyond my comfort zone. The stock continued to outperform big time. The key learning was that with certain stocks one should rather take a long-term view, say five years forward, considering the big picture and factoring fully the structural change in the growth trajectory and profitability. Then re-evaluate the target price rather than selling it early when it reaches the estimated target price.

Sometimes the most-hated stocks can provide a great opportunity if one is willing to move away from the crowd and do some original deep-dive work. After the scam erupted at Satyam in 2009, the stock crashed more than 90 per cent and was virtually an un-investible institutional stock. When we evaluated the company closely in 2012 as a contrarian idea, we did some channel checks with

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its customers and peers and found that the company continued to have a substantial business even after the crisis, with a diversified client base and a core competency in enterprise IT solution. The balance sheet was reasonable, old management was out and valuations were bombed out. Only if it survived and got the right leadership, it could be a great turnaround story.

We evaluated the company taking in the worst-case scenario and found a good margin of safety. We invested early in the stock across our funds and very soon the company started to get noticed not only by other investors but other peers and was acquired by another tech giant later, giving handsome returns. Taking such large contra calls requires teamwork to thrash out the various things which can go wrong and to build conviction.



Vetri Subramaniam Head Equity, UTI AMC
‘Securing financial goals is more important than maximisation of returns’

The early part of my investing career was a long cold winter – the market was lower by 23 per cent between June 1994 and April 2003. But it taught me a valuable lesson – companies that allocate capital efficiently and earn a healthy return on capital are more likely to survive and create wealth. I also learnt to differentiate between the top-down perspective

of economy/markets and bottom-up stock-picking. I could be worried about the economy and market and yet remain invested in a company to reap the benefit. In fact, this schizophrenic ability is key to good investing outcomes.

The most important investing lesson for me personally has been about asset allocation. The market meltdown of 2000-01, in which my personal stock portfolio witnessed an 80 per cent drawdown, was a reality check on my risk appetite. Thereafter, securing my financial goals has taken precedence over maximisation of returns. And in taking asset-allocation decisions, there is no better guide than valuations.

Anand Radhakrishnan

Managing Director & CIO – Emerging Markets Equity - India, Franklin Templeton

‘There is a reason some companies trade at a premium to others and these reasons don’t disappear’

There are many lessons. If I have to highlight one, I will focus on a common mistake that we all commit, i.e., buying a company hoping that it would be as successful as one of its more esteemed peers. This is called ‘playing relative value’.

Typically, investors who have missed out on one good company in a particular business would invest in the next one, hoping that it would catch up with the first company. Typically, such a company will look cheap relative to the first company and hence would easily justify the purchase. However, over a period of time, the two companies will keep diverging in real business performance and the valuations will never converge.

My specific learning on this is from the tech-boom days when I missed a well-managed fast-growing IT company. I tried to compensate by chasing smaller and weaker ideas and some of them worked but only momentarily. Luckily, I realised my mistake, quickly corrected it and survived the subsequent tech-bubble mayhem. This learning is applicable to all sectors, be it banking, gold retailing, telecom, etc. There is a reason some companies trade at a premium to others and these reasons don’t disappear. Hence, the valuations gap doesn’t go away too.

Sankaran Naren

ED & CIO, ICICI Prudential AMC

‘Pre-mortem of an investment idea is more important than post-mortem’

Over the course of my investing journey, four stalwarts namely James Montier, Howard Marks, Michael Mauboussin and Dr Atul Gawande have played a key role in shaping the processes I follow today. Each of them helped me in becoming a better investor by introducing me to certain concepts.

James Montier helped me develop the mindset of a contrarian investor. Having a contrarian approach to investing includes knowing the counter view on the stock, having a grip on intrinsic value and being cognizant of the risks involved. Howard Marks demonstrated that in the world of investing, cycles matter. Pre-mortem of an investment idea is more important than post-mortem – this is the theme I picked from Michael Mauboussin and finally Dr.

Atul

Gawande introduced me to

the

world of checklist. The checklist approach helps in minimising mistakes and aids in reinforcing investment rules, especially at a time when emotion is ruling high in equities.

I have consciously kept away from following any Indian market stalwarts on account of the fact that they may tend to have some biases, an impediment which is likely to be compounded with my own biases.



Navneet Munot ED & CIO, SBI Funds Management

‘The single biggest moat in India has actually been the management’

The dot-com crash at the turn of the century; the ghastly 9/11 terrorist attacks; a once-in-decades global financial crisis; a decade plus of persistent deflation, even in the wake of unconventional monetary measures that eventually culminated in negative crude oil prices; demonetisation; and of course, the once-in-a-century pandemic in COVID-19 – the so-called black swans have occurred with high regularity in financial markets. And while this underscores the need for robust risk management as being integral to the investment process, it also suggests that the fascination with market timing is futile. On the latter point, who would have imagined the Nifty, which was languishing near 7,600 when there were 500 COVID-19 cases in India, to be at 10,000 as the cases shot up to 3.2 lakh? In our view, the more sustainable and largely controllable source of alpha creation is identifying good businesses.

And what is a good business? The one with enduring moats, but then again what is an enduring moat? While Porter’s Five Forces Framework doesn’t talk about it and Warren Buffett’s famous quote “You should invest in a business that even a fool can run because someday a fool will” is popularly interpreted to even argue against it, in our experience, the single biggest moat in India has actually been the management. It is this one factor that has led to the winners of the past few decades in India coming from apparently plain-vanilla and, in many cases, outright commodity sectors, ranging from lending to consumer non-durables to cement to paints, and such. Some aspects of management quality are measurable, such as the capital-allocation track record, risk management and accounting quality. Certain others need a more subjective assessment, such as fairness in dealing with all stakeholders, innovation mindset and the ability to adapt to the ever-evolving macro and industry dynamics.

The quality of management is all the more vital amidst the current chaos. With a deadly mix of issues ranging from a pandemic, country-wide migrant crisis, cyclones, earthquakes, border tensions with neighbours, a ratings downgrade, a severe slowdown

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all coming together, India’s resolve is being tested.

Adding to the macro woes, disruption is becoming a norm, be it around consumer behaviour, technology, policy, and so on. The response can be to either hope for normalcy to return or seek opportunity in this apparent chaos. Firms that take the latter approach are likely to survive and thrive.

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Planning will help but more important will be creating strong feedback loops to prepare for the unknown-unknowns. Risk management should evolve to

account for black swans, as also newer risk areas, such as cyber security. Scouting for talent will be important, as will be re-skilling of employees amidst the new work-from-home regime. Treating all stakeholders fairly amidst the crisis will be vital to building trust that in turn will help create long-term value.

As investment managers, we are anxiously excited as we scout for these winners amidst heightened volatility. Yet like managements of investee companies, we need to keep evolving too. Using quant, AI, forensic accounting, ESG capabilities, and expertise from macro and credit to complement the traditional fundamental analysis will be key to creating long-term value for equity investors.





Taher Badshah CIO – Equities, Invesco Mutual Fund

‘Take a balanced approach at all times’

The market is a great teacher, who provides lessons almost daily. Over the years, of the many that have come my way, a few practical ones that have stayed with me throughout are:

- Humility: Bring your best judgement of things and conviction to play but beyond a point do not fight the market forces.
- Have a process that works for you and follow it with discipline.
- Take a balanced approach at all times: Do not swing to extremes, be it in stock selection or portfolio construction.

- Resist panic reactions where emotions overtake investing logic.

- Place risk ahead of return.

All these have been shaped over time by some very profitable and a few painful investing experiences.

A very powerful investment concept that I have frequently encountered and benefited from is ‘value migration’, which if seen to unfold in a large scalable fashion can lead to tremendous wealth creation for relatively extended periods of time. I constantly try to keep an eye out for such an opportunity.

Neelesh Surana CIO, Mirae Asset Mutual Fund

‘It’s important to construct a diversified portfolio which could handle mistakes’

In investing, discipline is everything. However, there is a thin line between discipline and rigidity. We seek to construct a diversified portfolio, which could handle mistakes by not taking disproportionate calls. Disciplined approach to investing, with focus on ‘quality up to a reasonable price’, will always help to deliver a satisfactory track record. There are two key aspects of investment decisions in the institutional format:

Stock selection: Our experience suggests that at an aggregate level, alpha generation has been from stock selection rather than sectoral calls. The focus should be on stock selection through bottom-up approach in growth companies available at a reasonable valuation. Most of the past wealth creators or destroyers can be traced on the analysis of three basic buckets: business selection,

management evaluation, and buying discipline while valuing to maintain the ‘margin-of-safety’.

Portfolio construction with adequate diversification: The most important part while constructing portfolios is to avoid big mistakes. We believe that no sector, stock, style or theme should be at a huge divergence to the benchmark. To give an analogy from boxing, there is quote in Ryan Coogler’s movie *Creed*: “It isn’t about how hard you can hit, it’s about how hard you can get hit and keep moving forward.” In this context, it’s important to construct a diversified portfolio which could handle mistakes and yet deliver decent risk-adjusted returns.



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