Aditya Birla Sun Life
AMC Ltd.

ADITYA BIRLA
CAPITAL
ASSET MANAGEMENT

MARKET MASTERY

Insights from a Veteran Fund Manager

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Markets can be a complex place for the uninitiated. But there is enough and more to learn for the curious mind. One of the richest sources of information can be the insights from practitioners who have spent decades understanding its nuances. In our new series of Market Mastery, we bring you some important investing lessons from fund managers themselves.

One such professional in the mutual fund industry is Mr. Mahesh Patil, Chief Investment Officer (CIO), Aditya Birla Sun Life AMC Limited (ABSLAMC). With over thirty years of rich experience in fund management, he oversees over INR 3 lakh crore of assets and leads the investment team. He started his career at ABSLAMC in 2005 and began by managing the flagship fund, Aditya Birla Sun Life Frontline Equity Fund, for 19 years of the fund's 22 years of existence.

Here's some investing wisdom from a fund manager with three decades in markets. He shares that although his approach to investing has evolved over the years, he has always prioritised purchasing quality companies that are expanding faster than their industry average. He emphasises that as fund managers managing public money, one carries immense moral responsibility and fiduciary duties towards investors who have entrusted their hard-earned money to build wealth.

Mahesh reflects on the six important things that he has learned about investments.

1

Back your winners

Warren Buffet said,

> "The stock market is a device for transferring money from the impatient to the patient."

For most investors, the most difficult decision is when to sell or hold a stock as compared to deciding when to buy. It depends on each person's risk tolerance and psyche, though, and there isn't a single technique that works for everyone. When you record a large gain in a stock, it's human nature to lock-in some gains by selling, especially when you are unsure of the market dynamics. To prevent missing out on the long-term compounding, one should fight the impulse to sell too early looking at near term gains. Rather one must focus on the long-term potential of the business and question if the business fundamentals are intact. In one's portfolio, there will only be a handful of quality stocks which will be multi-baggers and they are these are the ones which can make a big difference to overall portfolio alpha, so nurturing them is extremely critical. Holding onto the winners and following the market through cycles is essential if you want to gain from the power of compounding. In such cases buy and hold is the best strategy, while trimming occasionally, only to manage the active risk tolerance threshold.

2

Growth backed by great management is a winner

Research, Research, and More Research! Investing in a company's strong leadership and foundation is always a good idea. The key to spot a multi-bagger is a company with high growth (more than 15%), which is profitable (ROCE more than 20%) and reasonable valuations. High growth many times is a function of the industry in which the company operates and its hunger to expand its addressable market. The profitability is largely a function of the moat in the business and the quality of leadership. Over the years, I have realised that betting on the right management is the single most important factor to get a great winner. A capable and visionary management can make the right capital allocation decisions, continuously innovate, and navigate the company effectively across business cycles. In many Indian companies that are promoter driven, it boils down to betting on the right promoters. The best time to buy a great company at reasonable valuations is when its going through a difficult phase in its business cycle. It pays to be countercyclical in such cases, especially, when you are looking to build sizeable positions.

3

Trying to time the market is futile

In my experience, attempts to predict the direction of the market have been mostly futile. In trying to do so, especially taking cash calls in portfolios to protect against an expected market correction has invariably meant a missed opportunity. The market has its own wisdom, and it does not behave the same way as one would expect based on past experiences. Since Indian markets have been secularly long any cash calls taken in the past have detracted overall alfa. Hence, it pays off to remain fully invested, except for some cash to manage liquidity. Also, taking a strong market view, bullish or bearish, can bias your decision to buy and sell stocks.

4

Keep plucking the weeds for a healthy portfolio

As investors, we should constantly be aware that not every investment we make will turn a profit and that underperformance may be caused by several different circumstances. At any point in time, an average hit rate (stocks outperforming benchmark) of above 55% on portfolio stocks can be considered a good outcome. The key difference is what we do with the underperformers and how soon to weed them out of the portfolio. These stocks slowly corrode your portfolio alfa and block good money waiting to be deployed to other winning or new ideas. Sometimes a fresh perspective from peers can help, to play the 'devil's advocate' to reevaluate an underperforming idea that one finds difficult to come out of because of certain biases. Your emotions should never guide your decisions.

Sizing exposure to create impact and manage risk

It's very important to analyse every stock on a risk-return framework. In certain cases, especially small-caps even liquidity is important. A risk management strategy is necessary for protecting the portfolio from large drawdowns during major market corrections while it continues to participate on the upside during market rallies. Hence, the sizing of stocks and managing overall portfolio skew is equally important. While high-conviction ideas need to reflect in large active weights in portfolios their sizing is critical to manage perceived and unperceived risk. Thus, a riskier (volatile) and illiquid stock will have a relatively lower active weight in a portfolio. Looking back, it's equally true that when you have identified a good high-quality winning idea early (decent margin of safety) make a sizeable allocation to make the most of it and have a meaningful impact on the portfolio. When manging large size funds this discipline is very necessary to manage volatility and maintain consistency in performance.

Beware of Biases

Investment managers are subject to various mental blocks due to their constant exposure to the markets. Humans use a blend of reason and feelings to make decisions. When making investments, our preconceived notions or emotions can greatly influence our choices. We often try to simplify complicated information, which causes biases in the decisions we make. It's crucial to pay attention to the facts rather than the noise in markets.

Style biases are common and cannot be completely avoided. The only way to manage it is to first know one's style and remain consistent with it across market cycles. One of the ways to overcome biases is to use a quant-based framework to show the mirror. This can be an objective way of looking at a stock or portfolio which takes into effect the market feedback loop to question the positions when the signals are contrary to one's beliefs. Such signals should be critically evaluated to take any course correction if necessary.

I would like to end with one of my favourite value investing quotations from Benjamin Graham, who stated in his book The Intelligent Investor, "To invest successfully does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding the framework."