INSIGHTS

# ARE YOU GETTING LEFT BEHIND IN THE INVESTING GAME?

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It may appear difficult to believe today but there was a nearly 50-year period from the 1920s to the mid-'70s when India and later, India and Pakistan, dominated field hockey, winning the gold almost every single time.

And, then suddenly one day it all changed and it has taken nearly another 50 years for India to be even back in the reckoning.

The question is: What happened?

The playing field changed - in this case literally.

The traditional playing field of grass changed to AstroTurf and the skills required changed from stick work, dribbling, etc to fitness, speed, and so on. These new skills, in turn, depended on superior nutrition and training tech.

So, at all levels of the game, from the field to training to nutrition, deep science and tech took away the edge that the “traditional” players enjoyed. They were simply out-muscled and out-gunned in this tech arms race. They didn't stand a chance.

The Traditionals became history.

Sport after sport has gone that way. Remember Tennis legend Bjorn Borg making a comeback with his comfortable wooden racket, in face of Titanium rackets and beating a retreat, never to be seen again on a tennis court?

**Bottom line: Once the playing field changes, there is no option to continue to play by the old rules and with the old skill sets. If you choose to do that, you will be left far far behind.**

It is the same as an auto company saying today that it will stick to the traditional combustion engine and not look at electric vehicles.

We all know how that story will end for any manufacturer who says/ does that.

## The Playing Field is changing in Investment Management ...and How!

Advanced tech is doing to investment management, what it did to sport.

Traditionally, investment decisions were made only by the human mind. There was only one way to do things. If you put your money in a mutual fund or a PMS scheme, your "human" fund manager would painstakingly analysed company and industry data in order to decide where to invest.

Think of Warren Buffet and Peter Lynch.

That's the way most fund managers still do it. They attend conference calls. They read annual reports (at least you hope they do!). Almost all investment management practices today, remain frozen in the 1940s-1990s time warp.

It's all touchy-feely old school...still.

But there is seismic change afoot...already. And, if you and your investment managers do not change, you will be history like the old combustion engine.

## Why the Human only model of Investment Management no longer works

For one, a large part of what made the traditional model work was getting additional or different information by meeting company management. This was true not just of India but of all markets around the world where large fund managers could sit in a closed room with a company and get information.

I personally have done plenty of that - meeting companies for decades to glean that extra bit of information or insight - going around the countryside, from steel manufacturers in Jamshedpur & Tarapore to Aluminium plants in Renukoot, auto ancillaries on the outskirts of Chennai & the NCR to pharma companies around Hyderabad.

I would even say that it was the most fun part of the job as an equity researcher!

However, the finest output is not about what is the most fun for you individually but about what works the best...in this case, what results in an optimised portfolio. The edge that the securities industry or fund managers had in getting information from companies has been regulated away across the world - information availability has been made uniform.

In fact, now the problem is that there is an absolute surfeit of data that is humanly unmanageable.

## And, this is where the machines come in...

To handle tons of data, you need advanced computing power.

There are mathematical models that dispense insights at speeds unimaginable in the past. They can analyse more securities AND more data points in each than is possible even for large teams of humans.

For example, the models we use at First Global analyse 25,000 securities globally AND hundreds of factors for each security.

Machines "learn", quicker and better than humans ever can.

Most important, they can do this consistently and without bias - something which is impossible for human beings. The Machine, or rather the AI & ML-based system, is very consistent. Even if I had a thousand analysts analysing 25 securities each, they will not be consistent because different human beings faced with the same set of data will come up with different analyses, and different conclusions.

Nobel laureate, Daniel Kahneman has written a book on 'Noise' which is about how even well-qualified and experienced professionals, let us say, a set of doctors, judges, or insurance professionals presented with the same data and facts will come up with very varied conclusions and judgments.

And, this is with a very limited and well-defined set of variables like medical reports. The chaos will be even more in the case of a stock market with many disparate pieces of information.

Surprisingly, or maybe not, this variation is not even consistent across people - the same person may decide on an identical matter differently, depending on all sorts of factors from their mood to the weather.

Human beings are many things but they are almost never consistent. Their worldview keeps changing depending on their own circumstances. Besides the random variation across people, human beings are prone to a very large number of cognitive biases: storification, recency bias, hindsight bias, endowment bias, loss aversion, etc. and those are ingrained into us.

For example, due to the Endowment Bias, we tend to overvalue stocks that we already hold, compared to those that we do not hold.

Due to Loss Aversion, we are unwilling to admit that a mistake has been made and therefore fail to exit from a position if it means that we have to take a loss.

Of course, the list of biases goes on and on.

Even more disturbing is the fact that just understanding these biases makes little difference to how we make our decisions. This is because biases are hardwired into us for evolutionary reasons.

The great Daniel Kahneman has said that while he has spent a lifetime analyzing human biases, he has not been able to eliminate them from his own thinking and decision-making. This is a big advantage of the machine approach. The machine has no biases.

An expertly constructed Quant ML model can do bewildering things: it can read millions of research papers, balance sheets, conference call transcripts, and social media feeds!

**The best investment performance comes from combining cutting-edge systems with experienced human beings. That is where the investment game is moving.**

It can analyse a company's auditor's reports and management commentary. It can distinguish between good accounting policies and bad ones. It can granularly analyse ratios, in time series as well as cross section, across thousands of companies.

A well-developed machine can expertly analyse reams of data and discern patterns & linkages, across stocks and securities across the world. No set of humans is equipped to cast such a wide and narrow eye, contemporaneously, on data.

This begs the question: Do we need humans at all in the whole process along with the machines?

First, let me tell you an anecdote. You would have heard that the IBM supercomputer - the Deep Blue – was pitted against the then chess world champion. Gary Kasparov. And, in the chess match, the computer won. This was sensational news at the time.

What you may not know is that in 2005 the same experiment was repeated with the supercomputer playing against, not the world champion, but good chess players armed with laptops, and who won? It was the chess players with the laptops.

So the human+machine system worked better than the best human, and it worked better than the best machine. Therefore, in the investment management context, you need human beings with those decades of market experience in order to code the machine correctly. This is why when only techies do it, it usually doesn't work.

But even the machine output is not the final word.

Over and above that, you need an overlay of human expertise because the machine relies on past data and there could be things that are not captured there.

Let us say, a pandemic is on the horizon, there are geopolitical tensions on certain borders there is an announcement by OPEC on crude production, all these things can be overlaid on the machine model by the human being.

To give a couple of real-world examples: in the beginning of March 2020, Italy and Japan were hit by COVID and began to shut down, with schools closed and all tourist attractions deserted. At that time, we took a call to be very conservative, increasing cash and non-equity assets, buying insurance, etc thus sidestepping the crash.

In 2022 we steered clear of some Indian stocks that our systems recommended based on past performance because Europe was among their main markets where we saw a slowdown on the horizon.

To summarise human inputs are required first to direct the coding and programming of the system which in some ways also codifies human expertise. And thereafter to provide an overlay of human wisdom that may not be captured in hard data after the machine has given its output.

The best investment performance comes from combining cutting-edge systems with experienced human beings. That is where the investment game is moving.

Make sure you don't get left behind!

**Devina Mehra** founded and runs First Global, which started out as a full service Securities firm and is now a Global and Indian Quant based asset manager.

She's a Gold medallist from both IIM, Ahmedabad as well as Lucknow University, where she got 8 gold medals.

She started her professional career in Citibank where she worked for 7 years.

In 1993, she quit Citibank to found First Global. Got membership in the Bombay Stock Exchange as an individual and then corporate membership in the National Stock Exchange.

From 1999, she set out to globalize First Global's operations to international markets by gaining membership of the prestigious London Stock Exchange and NASD, US in early 2000.

She has been widely quoted in the Wall Street Journal, CNBC, Financial Times, Forbes, Fortune, Business Week, Barron's etc. and has featured on shows like Smart Money on CNBC and The Mind of The Market on NDTV Profit, in addition to being a guest on several shows on finance and markets on several channels in India and abroad.

She was featured among the 50 Most Powerful Women in Business by Fortune magazine in 2022 and as one of India's leading entrepreneurs by Outlook Business & Entrepreneur magazines.