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Devina Mehra's portfolio tips: Avoid the big losses, avoid a big hit to your capital & then you will win

Synopsis

Devina Mehra warns investors about smallcap crash risks during euphoria. Emphasizes careful stock selection and managing risk to avoid losses. Advocates for cautious approach in volatile markets for better returns. In case of industrials, Mehra says: "I expect, sometime this year, maybe the story will be over. Of course, we have trimmed, we have changed stocks and we have done all of that but we are still overweight in that sector as we speak."

"Not maximising returns, manage the risk first because investing is a loser's game."

Devina Mehra, Chairperson, Managing Director and Founder, First Global, points out that on the smallcap side, many new investors do not remember what kind of crashes you can see there. In 2008-2009, the index itself crashed almost 80%. So, a lot of stocks were completely wiped out. The smallcap index level came back in 2016 and we had another year-and-a-half of a bull run in smallcaps and in 2018 again we saw a nearly two-third crash. So, those are the risks which people forget when the euphoria is on and when those stocks fall, there is no bottom and there are no exits. So, those are the things I would still like to warn the viewers about.

Mehra also says: "We are still overweight on industrials. But every quarter, the question we ask ourselves is whether the story over? Till now, our systems have not signalled that the story is over. But I expect, sometime this year, maybe the story will be over."

The markets are also looking different. What markets were looking in January versus what they looked in March, I think the mood has changed. Would you agree with me?

Devina Mehra: What has happened was not unexpected. The last time on ET Now, I had spoken about the risks I see in the small and microcap space and how the spectacular returns we saw in 2023 are unlikely to repeat, so that was one part of it. Also, if I go back to February, I had said that on our PMS portfolios, we have taken hedges because we saw some short-term volatility. On the other hand, on a one-year perspective, we were not really worried, which is why we did not take a cash call and thought a hedge was good enough because if there is an up move you do not want to miss out on that up move either. So, that was the balance we sought to achieve with a hedge. That is pretty much how it panned out. So, nothing that has happened up till now has been unexpected, at least where I am concerned.

Since what has happened was not unexpected, what should we expect after this so-called adjustment?

Devina Mehra: You will still see some volatility for at least a month or two, but as I said, I do not see a big risk of a crash. Of course, you have to choose the sectors carefully and choose the market cap categories carefully, you have to choose the companies carefully, all of that remains. But having said that, if you look at the Indian markets, we had that whole decade of 2010 to 2020 where the compounding was very low, barely above fixed deposit rates and that created that room for the market to go up.

So, we are not still above the trend line as far as the mainline indices are concerned. That is why the risk of a crash is not that high, but on the smallcap side especially, many new investors do not remember what kind of crashes you can see there. In 2008-2009, the index itself crashed almost 80%. So, a lot of stocks were completely wiped out. The smallcap index level came back in 2016 and we had another year-and-a-half of a bull run in smallcaps and in 2018 again we saw a nearly two-third crash.

So, those are the risks which people forget when the euphoria is on and when those stocks fall, there is no bottom and there are no exits. So, those are the things I would still like to warn the viewers about.

What is your take on industrials now? It appears that a new wave of positive notes are coming in. Just today, there is a brokerage upgrade, ABB has a 40-50% kind of a target upgrade. After the recent lows, the engineering and capital goods mid-tier names are very active. You have been overweight on industrials for some time now. Are you facing challenges on the valuation front or are you happy to hold them?

Devina Mehra: I would like to say that the sell side, which is the brokerages, are normally behind the curve and most people kind of discovered industrials in 2023. We have been overweight since October 2021, so two-and-a-half years already and obviously, in 2021, they were coming out of 12 years of compounding at 2-2.5%. So, the room was there. We are still overweight on industrials. But every quarter, the question we ask ourselves is whether the story over? Till now, our systems have not signalled that the story is over. But I expect, sometime this year, maybe the story will be over. Of course, we have trimmed, we have changed stocks and we have done all of that but we are still overweight in that sector as we speak.

What about the underlying valuations? While we may talk about the big picture, the cycle being supportive, private sector capex which has started, if I just look at dipstick, I am looking at the top five names -- Thermax, ABB, maybe Siemens, all of them are trading at PE multiples which are 50 to 60 times one year forward. Does that make them expensive or one should ignore the underlying PE multiples?

Devina Mehra: No, I do not think you should ignore PEs, which is why I said that over time there were stocks which doubled and tripled and we either went out or we trimmed and we moved into something else. So, while we have been overweight industrials, it has not been exactly the same stocks for two-and-a-half years, in some cases there have been, but a lot of them where the valuations ran ahead of themselves, I have not necessarily had the same stocks. So, valuations are never irrelevant.

What is this insatiable appetite for smallcaps really telling you about the market? From the recent lows the index has already recovered 7%.

Devina Mehra: Yes, but that is always in the nature of any of these euphoric places in markets or for that matter, any market whether it was crypto or anything else. There are a lot of new investors who thought and who are maybe still thinking that this is the place to make money and obviously there are patches when you do make money. But you have to see when it is getting into frothy territory and in any case in terms of philosophy, I always think that instead of maximising returns, you must first manage the risk because investing is a loser's game.

I was looking at mutual fund data, I think it was an ET exercise itself, where they looked at mutual fund performance and how the mutual fund schemes did in an up move and a down move and there was a very interesting statistic that one of the schemes which was right on top, outperforming 93% of the up moves was actually almost the bottom scheme in its category because it underperformed the down move.

So, when the market fell, it fell more than the market, which compensated for the fact that when the market went up, it went up more. Hence the schemes that ultimately came out ahead were the ones which outperformed the down moves where the drawdowns were not as much as the falls in the market, so that is always the basic principle that avoid the big losses, avoid a big hit to your capital, avoid losing, and then you will win. That is the way we manage it and that is the way I would recommend your viewers also manage their portfolios.

So, you do sense froth within small and midcaps and would you say that the best of the rally could very well be behind us?

Devina Mehra: Yes, you will have to look at it because now the SEBI-definition for the mutual funds of small and midcap is based on the number of stocks. It is a little difficult to look at it that way. The riskiest part of the market is below Rs 5,000 crore market cap. Below Rs 1,000 crore, we do not even look at it. But between Rs 1,000 crore to Rs 5,000 crore market cap, we are quite cognisant of the risk. Therefore, we limit exposure in all of that. Some of the midcaps are pretty stable companies as well, not everything there is frothy.

Within PSU, where do you see scope for earnings and price appreciation? Where do you see opportunity within the PSU space?

Devina Mehra: PSU is a very diverse space. You cannot club banks and oil companies and capital goods companies all together, just because they have the same ownership pattern - really you have to look at the categories. If I look at it today, the PSU space is where we would have a little higher exposure is PSU banks. We are overall underweight banks, but within banks, we are overweight PSU banks. But everything else you have to look at and make sure that sometimes there is a lot of euphoria that so and so company has got an order, but orders can work both ways because usually during project execution, there are overruns. You get the money for those overruns, there are all kinds of complications and now the valuations are not very cheap, so you have to look at each company individually and see what is going on.