2nd Anniversary Special

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What I Learnt

India's best market minds

on their investment journey so far

Research diva

SANJIT KUNDU

Devina Mehra

Age : 45

Organisation : First Global, co-founder & research head

Number of years in the market : 24

The first stock that I ever looked at : Reliance (Case study at IIM-A)

The only reason I come to work everyday : This is the only job where you get paid to learn

If not in the stock markets then I would have been : A professor/curator/travel & food writer

The book that inspired me the most : Against the Gods by Peter Bernstein

One must read market classic : Valuation by Tom Copeland

Number of times have watched the movie "Wall Street" : Thrice

What I do to unwind : Reading, travel, playing with my daughter

My kind of food : Seafood

My kind of music : Old Hindi-preferred lyricist - Sahir & Kaifi, early Beatles

She's been with him when they started out; she stood by him when they were *hounded by the authorities, she's been there every step of the way that they have built a world class institutional brokerage. She is Devina Mehra, he is Shankar Sharma. Together they are First Global. Intensely focused, yet down to earth, she spearheads and oversees all the research that streams out from their institutional brokerage. But for her, the achievements so far are still a work in progress as they meticulously work on deepening their global footprint. Besides the space at home for their more than 2,000 books, there surely must be dedicated shelf space for all the gold medals she bagged during her "exceptional" academic career. Until she joined IIMA, Devina had not looked at a balance sheet nor had she studied economics or knew what a share or debenture was. But now she doesn't bat an eyelid questioning mainstream market dogma. Case in point, buy and hold for her is something that used to work in the past and is irrelevant in today's rapidly discounting markets. She also finds it amusing that business schools still can't get out of teaching CAPM and Beta despite it being hardly useful for any kind of predictive work. In fact, right now, as you are reading this, her hyperactive cortex might just be questioning if stocks have indeed outperformed bonds over the years.*

In 1986 I joined Citibank and worked there for seven years, but I felt like moving out after three years as I had learnt what there was to learn. Then within the bank I really liked the job of a credit analyst and I had to fight my way to get into it. What was driving me then was the quest to learn and, now, that is what I tell recruits who come in. That unless you have that fire in you, to the degree that you are willing to do it for free, you will just not be able to differentiate yourself from the rest out there. Research is a lot of work; you have to keep thinking about how you can predict things better. There is opportunity everywhere as both the quality and integrity of the analysis are not what it should be in terms of how much work gets put in and whether you are actually told what you should be.

Becoming a credit analyst in hindsight was pretty good training for becoming an equity analyst. That was where I learnt the most: what cash flows was all about; what could go wrong; that equity analysts tend to focus on the upside and credit analysts, usually, don't participate in the upside and have to be careful on the downside. It needs a whole different mindset and the whole discipline of meeting companies in your portfolio or plant visits, which was something that I enjoyed the most and other analysts hated. So I ended up doing plant visits for other analysts as well.

The other obsession was, if I was working on a particular industry or sector, people should not be able to ask me a question I can't answer. It was also good training in terms of getting information out of people, at times company tended to be closed even to their bankers. The trick was to be very well prepared; the whole thing had to be absolutely clear in your mind, so that you could have that interaction on a very conversational level.

In the 1993 budget they allowed FIIs in and that is when I took that leap of faith. We had a feeling that the markets would get professionalised and there will be an opportunity for people who understand things better to service professional investors. From thereon much of the learning was on my own. Even the MBA course just had a general grounding in finance and economics. It had not taught me what was precisely required in the

My learning

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markets. Cash flow analysis was not something that was greatly emphasised nor were valuations, so Tom Copeland's book was highly useful. Fortunately, by that time because I was a credit analyst I understood a lot of big companies like HPCL to Gujarat Ambuja, to Tata Steel and that gave me a headstart. In the beginning as we did not have a large team of analysts, I did a lot of traveling meeting companies all around the country. At that time companies did not know what an equity research analyst was, and they would say why should I meet you? I did a lot of intense company meetings and number crunching and I used be quite disciplined in that because I did not like taking a lot of notes during meetings because I felt that way you do not get much information and so everyday no matter how late it was I used to make my complete notes so that I don't lose information. So it is interesting from a point of view of what someone tells you at a point in time and what happens three months later. And unlike in a bank credit report where what you write never gets shown to the client, with a stock research note, because it gets public, companies used to get a little upset with a negative report.

The main thing is that there is a story that the numbers tell you, so it is always useful to look at the long term history of a company's numbers.

Like last time you had a recession, Tata Motors had this pattern through several ups and downs, they would build up inventory into the recession and suppliers would not get paid, so that comes through very clearly in the numbers and again you have to question management. That's another important thing I tell my analysts - you think that management has been doing this for 20 years or 50 years and they will know better but that is not the case - If you come with a broader perspective you probably know what is happening in other industries as well. You can have insights which the management might be missing out because they are too close to the action. Very often they might just project the immediate past and that we find repeatedly on both sides. Of course there is a tendency to be optimistic but we found this on the other side also.

In the late 1990s commercial vehicle (CV) recession, we had a done a regression model projecting CV demand and this was after two years of recession, and we had said that this year we will see 25 per cent volume growth, and we got calls both from Tata Motors and Ashok Leyland that this is too optimistic and you should not work with more than 10 per cent. But we stuck to it and the number was almost half a per cent point of that. So both ways, you tend to get stuck in the past, so if things are going badly you think they will continue to do badly and vice versa.

Understanding the business as well as understanding the numbers are very critical as a base. We have found that the deeper you go in anything, whether it is financial or macro-economic projections, the more you break it up the better your estimates are.

Again, we can all make models but it depends on what you put in that model. You have to keep an eye out on the alternative scenario that can play out. For example if Hero Honda is taking away market share, you have to ask, will it indeed continue to be that way? Back a few years ago it was vice versa when Bajaj Auto was going ahead and people were writing off Hero Honda. Again you have to ask; is that how it is going to be? Then you also need to understand the impact that topline and bottomline growth will have on the balance sheet and cash flow. In many cyclical industries when the upturn comes, the big bang comes in the relatively poorer quality stocks, for they are the ones with the higher leveraging.

So then your auto-deduction says - fine, this company has a negative net profit margin (NPM) or 1 per cent NPM but if the EBIDTA goes from just 8 per cent to 10 per cent, the 1 per cent becomes 3 per cent. The tripling effect, if it continues over the next two quarters, the cash flow goes up and the debt gets repaid, then that reflexivity comes into being, as the stock does well in the market and the company is able to raise money. So those are the things that you have to think through.

We have never felt that markets were that efficient, for if that were the case, none of us would have a job but besides that how can you justify a stock doubling or tripling within two months or halving when in the fundamentals nothing could have changed so drastically for at least 95 per cent of the cases. But you will go wrong and at times if you are in the market you could be running up losses for yourself as well. So you thought that something was overvalued and yet it continues to run as we found out during the Internet boom.

We turned bearish on Infosys in 1998 end and from there-on it went up 10 times. At that time, it was 100 times earnings which we thought was too much. At 100 times earnings any quality of company is expensive and Y2K was the main reason why the stocks were running and we thought beyond this there has to be a lull in the business. 2001 cannot be the same as 2000, but the market in 1999 was very strong and we were probably too ahead. Amazon is an example that I remember. For 2000 end last quarter, beginning of 2001 when the results came out, for the first time it had a positive cash flow and we made a buy recommendation on Amazon. That too did not work out. The big learning experience was that you don't have 20-20 foresight, so at times you could be way-off on how the company will eventually execute. Even if you are right on that, you could be off on the timing.

We started out more or less as a purely fundamental house, but we found just because something was not fundamentally okay, did not mean that the stock price would react immediately. As we evolved, we found that we were missing out part of the picture. We realised that you can be too early and that can be very painful, it could result in a huge loss for a period of time, again in many times as we saw during the tech boom also that things which don't rationally make

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sense can run for a while, again there you don't want to be on the wrong side of a trade when something has momentum. That really came through our work and our bad experiences in the market, so we felt in our stock recommendations we could have been better in sense of timing. That is when we started adding more and more tools in terms of analytics and now we try to marry the two with the intent to time it, like Dell versus HP was a trade that was visible to us. About three years ago, HP was trading at a fraction of the price to book, price to sales of Dell and at some point we thought that trade would turn, and because we also had added-on tools we could time that much better. We then could actually wait while HP fell from $22 down to $18 and at $18 you could say that this is the best time to do this trade. Over a period of time, we continue refining these tools. The other thing that has changed is from being totally bottom-up it has become a combination as you realise that a large part of the money is made by getting the sector calls right or by looking at a multi-country approach than getting a country right.

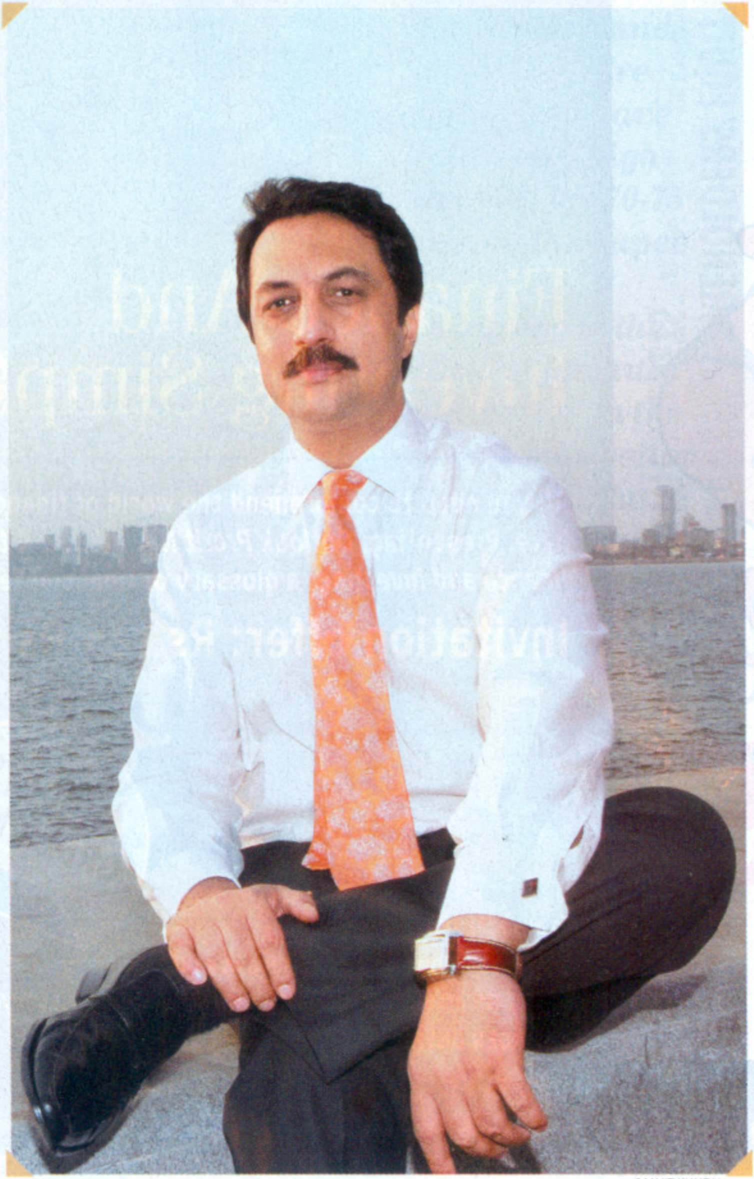
An often heard line in the business is: "I have never met a good investment manager who does not read." I think that is right because unless you feed your mind, nothing interesting is going to come out. Also a lot of books that you read might be just a couple of ideas but it can really open your mind, like "The loser's game" by Charles Ellis. This is a very interesting article; in fact I give it as a handout. Ellis says investment management has become a loser's game; I have to make the least mistakes for me to keep my job. Which is why then everybody becomes consensus, everybody has the same weighting as the Nifty or whatever index. Then there is a book called "The Number" on how earnings are massaged and what to look for. In terms of market history, there was a book called "Bull" about the whole bull market, "Against the Gods" was another book that I liked.

The whole enjoyable part in this business is you are getting paid to learn. I used to think during my Citibank days that, is there a job which will pay me to learn and that fascination remains. When people write a story they always want to know about the person's talent and what they did, whereas actually a lot more goes into the success. Another thing in this business we meet a lot of interesting people. We have consistently found that people who make it here have an open mind. This is a business where nobody has the final answers, most of the time. So people who are willing to listen are the people who keep improving, become better and better over time and are the most interesting to interact with.

Objectivity and willingness to work are crucial ingredients. Objectivity because this is a business in which you can easily get carried away, you need to see things for what they are, and not just extrapolate whatever is happening -- whether it is for a business or for a market. The extra two hours religiously spent reading builds up over a period of time into very large hours of focused work and study on a particular area. To succeed in a highly competitive business where many around the world are trying, to give you the extra edge, being talented is not good enough. You have to put in the hours and practice in a very clearly defined way. ☐

– Rajesh Padmashali

No holds barred



SANJIT KUNDU

Shankar Sharma

Age: 46

Organisation: First Global, Co-founder and chief global trading strategist

Number of years in the market: 25

The first stock I ever looked at: Asian Hotels

The only reason I come to work everyday: To do maintenance analysis

If not in the stock markets I would have been: A *Bahubali Neta* in Bihar

The book that inspired me the most: The Fountainhead by Ayn Rand

One must-read market classic: Analysis of Stocks by Edward and Magee

Number of times I have watched the movie "Wall Street": I know all the dialogues by heart

What I do to unwind: Watch movies, cricket and read crime fiction

My kind of food: Seafood at Excellensea, and Bengali food at Oh! Calcutta

My kind of music: Mohammed Rafi and Western Classical

When he quit Citibank in late 1989 after being there for less than two years, broking *was a profession for no-hopers and the Bombay Stock Exchange card cost Rs 55 lakhs. His first job in the markets was as a floor trader. The 1992 bull market helped him raise capital to co-find what has since become his passport to fame and envy. He has always been anti-establishment and a bit of a rebel. He speaks his mind whenever he is asked to, and for obvious reasons the world at large has a problem. It just can't get over the fact that this guy has raised political incorrectness in the market to an art form. He is hardly apologetic though; maybe there is some planetary conjunction, which halts him from participating in a popularity contest. He also makes no bones about having no allegiance to his views on the market and is ready to change it if the trend so demands. Needless to say, he seeks to ride momentum to the degree possible and has utter disdain for sugar-coated talk on long term investing.*

When I came back to India in 1988 from Manila after finishing my MBA at the Asian Institute of Management I was clear that I wanted to get into broking. That was because at that point, my view was that in about ten years, India would be one of the biggest markets in the world. Hong Kong was already a big financial centre, Singapore was getting there and it was only a matter of time before we would be swept in too. And if that indeed was going to play out, I wanted to participate as an entrepreneur and not be a small cog in the wheel at some big-name intermediary. While doing my MBA I had seen the movie "Wall Street". Though I had already made up my mind by then, it was still a huge endorsement. While it did influence me, I am quite ashamed to admit it. It's like saying you watched Deewar and then decided to become a smuggler!

The early days, post the formation of First Global was the best in terms of learning. It was a voyage of discovery, meeting companies, understanding businesses and trying to fathom what the market was all about. I didn't come with any notions, but I had an open mind, and was very clear that one needed to spend long hours reading and many years practicing this art to be successful at it. Buffett's annual reports are a must read for someone starting out. Then there are the ones written by Peter Bernstein, Charles Ellis, and countless others. Actually the whole point is you have to read hundreds of books because just a few won't teach you everything. Fortune also plays a huge role. In the markets making money is not luck, the luck part is taking it home as everybody in the market at some point makes good money. Taking it home is the talent part of it because participation in a bull market is all about showing up. But to make money across cycles and across many years, that is something beyond luck. My observation over the years has been that the majority always loses and the markets enrich a few at the expense of many.

The first major learning was that markets are not just about fundamentals. Technicals play a very big role, and in order to be successful, one needs to be holistic in one's approach. I am agnostic about management quality. Good stocks and good managements are two different things. In the run-up to the tech boom I bought stocks like Global Telesystems, HFCL, Pentamedia etc, which were hardly high quality names. In fact, it is my belief that good, blue chips managements rarely give you twenty baggers, as valuations reflect this with some exceptions. But a poor quality management getting perceived as becoming relatively better, whether in reality or not, makes for terrific re-rating. And when they fall, they also become great shorts. The other important learning is that you have to be a contrarian, but you need to pick the point very carefully when you become so. We always make our biggest mistakes when our minds get predisposed to a single perspective, and it is very hard to fight noise in the market. Getting on top of your emotions is necessary as it will always tell you the wrong things and force you to abandon all your principles.

My learning

My observation over the years has been that the majority always loses and the markets enrich a few at the expense of many

After having spent about 25 years in the market, my approach is now more macro and less micro. In the earlier years, a new window would open in one's mind everyday. Now, it's more maintenance analysis, since the mind has stopped accepting new forms of analysis. Also, one is loath to tamper with one's systems and methods now, since one has near complete confidence in them, and they have worked well for many years.

Your investing philosophy is shaped by the life you have led. It's really that simple. So if people say Warren Buffett is long term and he takes a 15-20 year view, that's because he was born in America, in that certain period of time. Today nobody can take that view in America. A guy in his teens having gone through the last 10 years of virtually no growth will not think like that, but post the Second World War there was an absolute go-go economy and you could predict out 20 years and you could be right. So his philosophy was not a great philosophy, just the era that we was born in and the good life that he had.

George Soros lived the exact opposite life, for him it was always trying to escape the Nazis and survive. Soros is a short term guy, that's the way he has been brought up. He is flexible to change and holds no long term views. That is possibly why he has been a greater influence and my approach is closer to his. Remember one thing, in markets a stock can be a great sell at Rs 100 and be a terrific buy at Rs 300. That is the nature of this game; I have no problem in changing my view. People get fixated saying if you didn't like it at Rs 100 how can you like it at Rs 300? That is irrelevant, stock fundamentals improve when the stock price goes up. Tata Motors at Rs 130 could have easily headed to oblivion, I had to be negative on the stock, but at Rs 250 the numbers have turned around and they were going out and raising capital. There were only two issues – trucks were not selling and there was no money. As both problems got solved, I have more comfort buying it two times higher. So it is not the price but simply the fact that risk diminishes dramatically for a bankruptcy candidate when the stock price itself goes up. Refinancing becomes much easier; people like to buy stocks which are running up. And then rising stock prices lend a little respectability, therefore it justifies higher PE multiples.

In short, life too is like trading, so be ready to make a U-turn if the trade goes against you. That is one must-have attribute to succeed in the markets. You have to have the ability to visualize an alternate reality, contrary to the one that is prevailing at that particular moment. That flexibility can come from a deep knowledge of financial techniques, reading everything you can lay your hands on and seeking different experiences. But question everything you read and hear and never accept anything unless you have dissected it, and looked at it from many angles, be it the daily news, a movie, a book, whatever. So stay humble and don't get carried away, for it is a capitalistic game, not a socialistic one and that is why I don't get too intellectual about it. ◻

- Rajesh Padmashali