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ETMarkets Smart Talk: We use AI & ML system to pick stocks from 25000 securities globally: Devina Mehra

Synopsis
Crude has corrected substantially from the 2022 highs and since that determines the prices of a lot of downstream products, it can provide a cushion both to the economy, as well as to corporate earnings.

Remember that all of these are narratives, not facts.

"We now use a rigorous Artificial Intelligence and Machine Learning system to do the first cut of stock picking after which we use human expertise to pick say, 50 stocks out of the top 65-70," says ***Devina Mehra, Founder, Chairperson, and Managing Director at First Global.***

In an interview with ETMarkets, Mehra, said: "Globally, we look at almost 25,000 securities all of which would not be possible to do humanly and even if a large team does it, not everyone will look at the same facts in the same manner which is possible only in a system-based approach" Edited excerpts:

What is your view on the markets – are we in a recession or heading for one? IMF has lowered the growth forecast but we are still the fastest-growing economy.

The technical definition of a recession worldwide is negative growth for two quarters, which is obviously not something that India is facing.

In fact, other than the Covid lockdown we would not have seen GDP declines for decades.

Of course, our Pre-COVID per capita income was crossed again only recently. So, in per capita terms there has been barely any growth for 3 years.

Plus, if your account for the fact that the growth has been skewed toward the higher-income growth group, the picture looks even worse.

So, we can be the highest growing economy and still not be in a great place as far as the majority of the citizens are concerned.

The fact that 60% of the population requires free food tells you the degree of distress in the economy, as does the high level of unemployment, especially of the youth.

This is somewhat masked by the fact that the organised sector employees and higher income groups have done well which shows in the good sales of luxury cars, high-end homes etc. but the growth has been uneven.

What may provide a boost to the growth this year, as well as reduce inflation, is if crude remains at lower levels.

Crude has corrected substantially from the 2022 highs and since that determines the prices of a lot of downstream products, it can provide a cushion both to the economy, as well as to corporate earnings.

The broader market remained an underperformer in FY23. What is your view on the small & midcap space for the next financial year? How should one pick stocks in that category?

I usually don't give a view for a whole year and for small caps in particular, the calls are often companyspecific as this is not a category that one can buy as a whole...the dynamics within it vary a lot.

In the portfolios we manage, our orientation is also first towards risk management and only then for return management. Hence, the small-cap exposure in our PMS rarely goes beyond the 15 to 20% range and, that too is invested only in liquid stocks in the Rs. 1000 to 5000 crores market cap category.

Having said that, our systems are showing that small and mid-caps may well outperform as a category at least from a 6-months point of view.

How do you pick stock for investing – which filters do you deploy while picking the stock?

We now use a rigorous Artificial Intelligence and Machine Learning system to do the first cut of stock picking after which we use human expertise to pick say, 50 stocks out of the top 65-70.

The system uses a very large number of financial and some other industry/ economy/ market factors, which are tested to see which ones give the best results.

On the financial side, while the broad categories are similar to what a manual system would use: looking at growth, margins, return ratios, cash flows, etc., a lot of nuances are possible in a systematic approach.

For example, looking not just at growth which is the velocity of change or the first derivative, but also the second derivative which is acceleration, and the third derivative which is jerk can give you some additional information.

Plus, various factors can be combined in a way that is not possible by human beings.

Factors are constantly tested to see which ones work, and this may vary from market to market as a factor that works in India may or may not work in the US or Europe and vice versa.

It is quite fascinating to see that systems can analyse not just reported financials but also flag when these financials themselves look suspicious...basically red flag a possible scam. For example, one of the red flags is if the compensation to auditors goes up unexpectedly.

Also, you can use the same set of criteria without bias or random noise on the entire Universe of stocks.

For example, in India, we look at all stocks above Rs. 1000 crores market cap which is approximately 700 stocks. Globally, we look at almost 25,000 securities all of which would not be possible to do humanly, and even if a large team does it, not everyone will look at the same facts in the same manner which is possible only in a system-based approach.

Piyush Goyal in a statement said that - Rupee Trade Arrangement to Help Cut Transaction Costs. Where is the trend headed? Is it good for India? What role will Dollar play?

In my view, the switchover from the dollar to other currencies, especially those from BRICS countries for either trade denomination or as a foreign reserve currency is going to be marginal.

Whatever has happened is being driven only because of the war-related sanctions and normally would happen only to the extent of bilateral trade with a country.

I don't think the world's Central banks want to hold Chinese Yuan or the Indian Rupee. In fact, in the last 20 years, the percentage of Central Bank reserves held in US dollars has barely changed.

China at least has a large enough foreign trade for some of it to move to its own currency. India is not big in the goods export market at all.

Of course, due to the sanctions right now India can buy oil cheaper which is a different thing altogether, not indicative of a permanent change in the relative importance of currencies.

How should one look at global investing in FY24?

Global investing is not something you should look at on a 1-year basis.

This is a long-term asset allocation decision, and should be treated as such!

As to why Global investing?

For one, India is only about 3% of the world market capitalization, so there is no reason why 90 to 100% of your assets should be in India.

Two, over time the Rupee depreciates, eroding the value of your portfolio.

From the time I started working to now, the INR has depreciated roughly 85% against the US Dollar... In the course of less than a single career!

This has to be taken into account in long-term financial planning, specially as more people or their children are studying and settling abroad which means their expenses are in hard currency.

Three, there is the risk of having all your assets in one basket which has been seen multiple times in the world. The one which had the biggest impact on me was the Asian crisis of roughly 25 years ago when in one year, markets in South-east Asia from Indonesia to Thailand, South Korea & Taiwan fell between 50 to 90% in dollar terms.

To put this in context, these were the highest-growing economies in the world at that time - the famed Asian Tigers.

This, in fact, was the trigger for me to think of globalising the First Global business so that I was not exposed to a single country risk.

Even in general, no theme runs forever: no asset class, no geography, no sector outperforms all the time, and you need to have the flexibility to change the allocation according to this.

For example, between 2003 to 2007 Emerging Markets went up 3 and a half times (Indian markets went up 6 times) even as US languished and could not even take out its 2000 pre-crash highs. But then the US outperformed for the 2010-20 decade and beyond. Clearly, this shows that leadership keep changing.

What you must be careful of is not making up stories based on what is happening in the market in the short or medium term.

I had spoken about this in January that if emerging markets do a bit better, you will start hearing all the stories about how the era of the US was over and the BRICS economies were taking over which were last heard a decade and a half ago and that has started to happen.

Remember that all of these are narratives, not facts.