'You should have a mix of equity, gold, fixed income'

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"Returns can be very variable in equity markets.'
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Illustration: Dominic Xavier/*Rediff.com*

In the final part of this hour-long interview with **Prasanna D Zore/*Rediff.com***, First Global's Founder, Chairperson and Managing Director **Devina Mehra** talks about sectors she likes and offers a four-point checklist for small investors.

- **Part 1 of the Interview: 'If you want to invest, invest quickly'**
- **Part 2 of the Interview: 'Investing is a loser's game'**

If I were a small investor and if I want to invest in companies, could you list five parameters that every investor must take before she or he invests in that company?

First of all, learn accounting and finance. Don't do very cursory (*research and then invest*). Just watching business channels is a time sink.

(*Spending*) a little bit of time at the beginning and end of the day to get the news or some particular interview you want to watch, please watch. But just putting it on (*watching business news channels*) all day (*is not going to help you*) and it is especially dangerous because you think you are doing something useful, but it is not something useful.

Get your fundamentals right on accounting and finance if that's not your field and you don't know that.

You have to look beyond just profit and loss account or the income statement which means what happened to growth in sales, what happened to margins, etc. But that's only part of the story.

If you want to really go into it (*invest in a particular company*), then you have to look at the balance sheet and the cash flow statement. That's very important.

Typically what happens is that when a company has a problem they will hide it for a while. For example, they will show sales, but they will not be realising money for those sales. It will all be sitting in receivables. Therefore their cash flows will look poorer.

So, investors must look at return ratios, that is, return on equity, return on capital, employed, whatever is driving them (*a company's sales and growth*) and also cash flows.

Those are things you have to look at and, of course, read the notes to the account, whether they are hiding something.

It is not an easy process, but unless you do that, you are not doing a thorough job. You are just like punting. Some of those things might work out also, but that is all pure luck.

Let's talk about noise in the markets. Lot of small investors worry about what happens in the US markets. They keep looking at what US Fed intends to do, etc. How do you keep away from this noise once you are invested?

First of all, it is not noise. Looking at global markets or global trends is not noise.

In fact, most Indian investors make the opposite mistake, that you are only narrowly focused on India, whereas (*understanding and observing*) a lot of (*global*) trends and a lot of our systems -- besides the one that I spoke about in detail, we have other systems also -- help you make certain crucial decisions.

About interest rates they are very relevant. Ultimately, if you look at the very fundamental basis, today's stock price is supposed to be a discounted value of all the cash flows that the company will be generating in the future.

If the interest rates are zero, as they were in the West a couple of years ago, then you are indifferent whether you get the $100 today or you get the $100 after five years.

But if the interest rates are 5 per cent, then that five years out $100 is worth less.

So, interest rates are very relevant to the stock market also from that point of view, because they change the benchmark return that you need to get and therefore the discount rate you use on cash flows.

Coming back to what the (*US*) Fed will do, (*it is*) likely to be a pause (*the US Fed did pause the hike in their benchmark rates with the caution that there might be two rate hikes going ahead depending on how inflationary pressures act in the US economy*).

We have never been in the camp which said that the Fed will start to cut rates in the second half of 2023 (*Many experts were of the opinion that the US Fed would start reducing benchmark rates*).

Only recently the markets have started to kind of price that in. But that was always our view.

Because inflation, when it reaches that high (*the inflation rate in the US had touched a high of 8.3 per cent in 2022 from a low of 3.2 per cent in 2011; in 2023 after the US Fed started propping up interest rates to tame inflation it had come to 4 per cent, still 2 per cent more than the Fed's targeted rate of inflation*), doesn't come down in two, three quarters. It takes a long time.

And what we have been seeing with central banks around the world is that no matter what indication they gave the last time around, they don't care about that. They care only about the data.

If inflation actually comes down or whatever is their parameter that actually shows results, they will stop cutting. But we have also seen the Reserve Bank of Australia, which paused (*rate hikes*) and then again has hiked twice. That can also happen (*with the US Fed*).

Of course, core inflation, which means inflation minus food and fuel inflation is still over 5 per cent, which is not low yet. My best guess would be that RBI will pause for now.

The RBI doesn't necessarily follow the US Fed because it depends on our circumstances and we have much more focus on growth (*for generating demand and growth interest rates have to be relatively low*).

In US the labour market still remains very good (*which calls for a hike in US Fed rates to tame inflation as higher employment leads to higher consumption demand*), whereas in India, we have the reverse problem of very high unemployment.

So the framework for RBI would be different from what it would be for the US Fed.

Luckily, for the RBI, for now, inflation has come down. I think RBI will pause for a while.

I don't expect a cut immediately or anything like that, but likely to be a pause.

Should small investors, who mostly invest in SIPs, mutual funds or PMS or Smallcase, be really worried about such events? Do you think such fears are reasonable?

You should not definitely run away just because the market has not been good for a while because that actually spoils your average return.

If you look at mutual fund data, for instance, it shows that people run away when the market hasn't done well. And then when the market has already run up a lot just before the peak, that's where the peak money comes into mutual funds.

If there's no high risk in the market, then better to be invested because you are not going to be able to time it correctly (*all the time*).

Do you expect a small correction in the days ahead? How do you look at the Indian equity markets, say one or two years down the line? What kind of returns can one expect from the market?

(*Smiles*) I have been in this market for 30 years and one question which I have never answered on Diwali Day or New Year Day,

is that where do you see the index a year from now? That's a wild guess.

If you keep a tally of what people say and what the index actually is for a few years, you will find that people will no longer give those projections because they are all over the place.

Daniel Kahneman talks about exactly this. It is something you cannot know. He calls it objective ignorance. Whatever you are saying is only a wise guess because markets are not predictable on a one or two year basis.

For me, the key takeaway from Rakesh Jhunjhunwala's life is that he understood the fundamental fact that there will be times when you will not make returns and times when you will make bumper returns.

As far as our systems show just now, the risks of a crash are not very high. I have been telling everybody that if you want to invest, then invest quickly rather than wait for a small correction. That kind of thing is not knowable in advance.

Overall, India looks good even in the global context. Primarily it looks good because that 2010-2020 period, a whole decade, was quite poor (*returns wise*), both relative to its own history and the globe.

If you look at the history of the Indian market, it was in the first decade from when the Sensex started, 1980-1990, we compounded 21 per cent. Then it was 14 per cent, then it was 17 per cent, and then for a whole decade, that 2010-2020 period, you compounded only eight-and-a- half percent at a time when FDs were at 8 per cent for a good period of that time.

Returns can be very variable in equity markets. That is why I tell small investors don't put 100 per cent of your money in equities, even if you are young.

What should be the ideal asset allocation mix that small investors should try to achieve?

It depends on what stage of life you are in and what your goals are.

A person who is six years away from retirement, the mix will be different from somebody who is 30 years away from retirement. Personally, I would say I pay a lot of premium for liquidity. I mean, I tend to err towards liquidity.

I have never invested in real estate. So barring one residential house, I've never had any investment as such in real estate.

You should have a mix of equity, gold, fixed income, depending on where you are in your life cycle.

Again, in fixed income, I do not like to take very high risk, because if I want to take risk, equity is there. I would not take individual credit risk or buy a credit risk fund.

So it tends to be more like Gilts (*government securities*) or maybe PSU bond funds or something like that, which on the credit side, the risk is not high.

No asset class gives you any guarantee.

Gold started to do well last year, when equity had not started moving last year for two-three months, everybody started saying I should have bought gold.

People forget that from 1983 to 2003, gold gave zero return. It crashed, and then it came back to its early 1980s level 20 years later. Nothing gives you a guarantee.

Which sectors look attractive to you for someone who has a three to five to seven years' investment horizon?

It's difficult to say which sector will look good for a five year horizon, because no theme lasts forever. Whether it is asset classes, whether it is geographies, whether it is sectors, no theme lasts forever.

We look at everything from scratch every quarter. If I have cash today, where will I invest? That's the question we ask, and we invest accordingly.

Today, we are most overweight on capital goods and industrial machinery. We have been overweight (*on these two sectors*) now for almost 20 months, since October 2021.

Every quarter we check if the move is over. Until now, our systems have been signaling that it is not over. So we booked some profits, we moved from one stock to the other, but we are still overweight on that sector.

I generally don't like banks. I'm a nervous investor in banks. I've been a banker; I know there are many problems that can hide in banking, even though, our biggest blockbuster call, you can say has been HDFC Bank, which we like since 1996.

We had done a report in 1996 which had a baby on the cover saying this is HDFC Bank today, and then it had Arnold Schwarzenegger saying that five years later, this is where it will be, and what a run that has been.

When we started our PMS, we had very low weightage to banks, even though banks are the highest index weight. For two years, that was the case and then in the middle of 2022 we went market weight on banks and with price action that's become overweight.

We still continue to like that. Not so much on non-banking, financial lenders because lending is a risky business. We have a low weightage there.

We are slightly overweight on the IT space.

Where we have added in this calendar year in both our rebalances would be auto, auto components, a couple of construction

companies, some pharma names. But not everything is a sector call either.

In 2022, our big two among our top five winners were ITC and Raymond, which were not sector calls at all. Those were more bottom-up picks. I can't say that the story will remain the same for the next three years or anything like that.

We have very diversified portfolio. We will not have a very outsized exposure to any one of them. What our systems don't like particularly still are some of the commodities. We don't much like the oil marketing companies, metals or real estate; even paints and durables, those would be what our systems don't like.

What would be your advice for small retail investors? Some general advice which does not talk about learning accounting or balance sheets because that's quite a daunting task. 99 per cent people would run away as soon as they read accounting and balance sheets...

(*Laughs heartily*) Four things:

Concentrate on asset allocation most of all. Know what your current asset allocation is because a lot of people have no idea how their net worth actually is split.

Be very careful on risk control and risk management.

Don't jump from one end of the risk spectrum to the other.

Do consider global diversification.

PRASANNA D ZORE