

Cracking the Investment Code



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Mark Sellers, a renowned fund manager, identified seven key traits of successful investors. Among these traits are the ability to pick stocks when others are panicking, an obsessive drive to play and win the game, and the capacity to withstand volatility. Sellers believes these traits cannot be developed in adulthood; they must be ingrained from childhood. This perspective highlights the importance of early exposure to the principles of investing and financial markets.

This contrarian approach, where one buys when others are selling, requires a deep understanding of market dynamics and a strong conviction in one's analysis.

Secondly, Sellers emphasised the importance of an obsessive nature towards the game of investing. This trait is not merely about passion; it's about an unwavering commitment to the craft. Successful investors live and breathe the markets, constantly analyze data, study trends, and seek new opportunities.

The third essential trait is the ability to withstand volatility. Markets are inherently unpredictable, with frequent ups and downs. An investor who can maintain composure and stay the course during periods of high volatility is more likely to succeed in the long run. This resilience is crucial as it helps to avoid panic selling and poor decision-making during market downturns.

Balanced Advantage: A Strategy for All Seasons

Given this backdrop, the balanced advantage category becomes even more important. This investment strategy thrives by buying when markets are cheap and selling as they rise, thus institutionalizing a method to benefit from market volatility. In essence, it smooths out the investment experience, making it more predictable and less susceptible to sharp downturns.

The balanced advantage approach aligns well with Mark Sellers' traits of successful investors. By adhering to a balanced advantage strategy, investors can better navigate market cycles, ensuring that they are prepared for both the highs and the inevitable lows.

Applying Contrarian Investing Principles

The principle of contrarian investing is that cycles tend to mean revert over time. For example, despite the negative cycle in Japan from 1990 to 2022, which led to widespread investor skepticism, there were still opportunities based on dividend yields and low interest rates. This long-term perspective is crucial for investors aiming to capitalize on market extremes.

Contrarian investing requires more than just high IQ and numerical skills. It involves understanding market sentiment and human behaviour. Warren Buffett's investment philosophy emphasizes the importance of traits beyond intellect, highlighting that successful investing is not merely arithmetic but a blend of insight, experience, and intuition.

Take the example of metals. In 2015-16, metals companies (except for two) said they were all bankrupt. When you hear every company is bankrupt except for two, you know you are at the bottom of the metal cycle. This means you can comfortably buy that sector from an equity point of view.

If you go back to telecom in this period from 2019-20, there was a situation where almost everyone in telecom was bleeding, and the number of players had come down. If you looked at telecom results, you would find that, barring one company, all the others were making huge losses. That again showed an extreme situation where you knew you were at the bottom. Go back to 1999-2000, and you'll find a new valuation model called "eyeballs."

What We Have Observed in the Past Decade

The past decade has been unique. Barring the COVID-19 market cycle, the period has been characterised by a relative lack of significant market falls, unlike the more volatile eras of the 1990s or the 2007-2013 period. During those times, there were notable market crashes, such as in 2008 and 2011, which provided ample opportunities for contrarian investors to do well.

This recent stability, particularly in the Indian equity markets, can be attributed to robust macroeconomic management. However, while broad market downturns have been scarce, sectoral cycles have continued to present lucrative opportunities for astute investors. For instance, from 2013 to 2020, the real estate sector saw little to no growth, showcasing a prolonged sideways trend. Physical real estate as an asset class stagnated, offering contrarian investors a chance to strategize and potentially capitalise on future rebounds.

The Importance of Sectoral Cycles

In 2020, certain sectors experienced significant upturns, validating the contrarian approach. Telecom, metals, and PSUs had endured long periods of poor performance before they finally turned around. Metals, for example, had been in a downturn for a considerable time, and telecom went through a substantial downcycle. PSUs, too, had largely underperformed until the market conditions shifted in 2020. These sectoral cycles proved the efficacy of identifying and investing in undervalued sectors poised for recovery.

Insights from Mark Sellers' Philosophy

Sellers identified seven traits he believes are crucial for anyone aspiring to become a successful investor. The first essential trait is the ability to pick stocks when others are panicking. In the volatile investing world, fear and uncertainty often dominate market behaviour. A successful investor must possess the courage and the skill to identify and seize opportunities during these tumultuous times.

People would say you could invest based on eyeballs. Go back to 2017, and you'll know that people started to look at something called the "value of sale." You could sell a mobile phone based on losses, but people were giving valuations based on the value of a sale.

Once you have a model where you can create a valuation based on just volume or value without any reference to profit, whether it is eyeball or gross merchandise value, you know there's a problem. Then you're closer to the top of a cycle. Many startups saw their valuations come down. That is an indicator of the top. If there are too many IPOs in a sector, one has to be very careful. If there are too many buybacks in a sector, it means one should be very positive. These are some ways to identify which sectors to be positive on and which ones to be negative on.

If you have many IPOs coming in a sector, I think management knows the valuations, and that's why they keep coming out with IPOs. That is how we identify cycles sometimes. You can make out that if everyone is worried about you making too much money, then it means you are towards the top of a cycle. On the other hand, if there is complete irritation, which might be happening today in the Chinese stock market, you know you are closer to the bottom. You have a situation where you can tell where you are by observing behaviour. The extremes are easy to identify, but somewhere in between is tough because you do not know when you are in the middle of the pendulum.

For example, in 1994, an open-ended mutual fund had a grey market premium. How can it be that in 1994, an open-ended mutual fund had a grey market premium? On the other hand, in 1998, that same mutual fund or something like that was trading at a 40% discount on net asset value. These types of extremes will give you an idea of where you are on the sentiment cycle. Extremes are easy to identify, but the middle is not easy because you won't know what's happening or how long the cycle will go on. You can identify the extremes, and when extremes happen, you can be sure you are not far away from a change.

Conclusion

Over the past decade, the Indian equity market has exhibited a relative calmness, especially when contrasted with the volatility of the 1990s and the period from 2007 to 2013. This stability can be largely attributed to robust macroeconomic management, providing fewer broad market downturns but presenting lucrative sectoral opportunities. The real estate sector's prolonged stagnation from 2013 to 2020, followed by the significant upturns in telecom, metals, and PSUs in 2020, exemplifies the cyclical nature of market sectors. These trends validate the contrarian approach, where identifying undervalued sectors poised for recovery can yield substantial returns.

Mark Sellers' insights into the traits of successful investors emphasize the necessity of intrinsic qualities such as courage during market panics, obsessive dedication, and resilience against volatility. These traits are essential for navigating the complexities of investing.

The balanced advantage strategy is in accordance with Sellers' philosophy, institutionalizing a method to benefit from market volatility by buying low and selling high. This approach helps smooth out the investment experience, making it more predictable and less vulnerable to sharp downturns.

The principle of contrarian investing highlights the importance of recognizing market cycles and understanding that they tend to mean revert over time. Historical examples, such as the prolonged negative cycle in Japan or the downturns in the metals and telecom sectors, illustrate the potential for significant opportunities based on market sentiment and human behaviour.

Looking forward, investors must remain vigilant, embracing contrarianism and leveraging strategies like the balanced advantage category to stay ahead. By understanding and preparing for market cycles, investors can position themselves to thrive during and despite periods of volatility. The lessons of past market cycles and the traits of successful investors provide a roadmap for sustained success in the ever-evolving investing world.