INVESTMENT CREDO

Principles and Guidelines Master Document

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“All men's miseries derive from not being able to sit in a quiet room alone.”

- Blaise Pascal

Preface

Successful investors have different styles of investing. Some might generate wealth through day trading in F&O. Others might buy and forget for 20 years. Yet others might make their wealth trading commodities, forex or cryptocurrencies. Each of these styles requires different sets of skills and temperaments. To be a successful investor, I would have to find a style that suits, magnifies and leverages on my strengths. Therefore, this document sets out to define my framework and style of investing – the principals and guidelines I will follow to ensure that I am able to survive and thrive as an investor.

“It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent”

- Charlie Munger

Objective

To be **consistently not stupid** in maintaining a **balanced equity and debt portfolio**, **through direct investments**, varying according to **general market conditions** and valuations, consisting of **value investments** and **positional trades** with **favourable probability distributions** in **fundamentally strong businesses** that are relatively **out of the limelight**, with **good quality promoters** and **high promoter holding** and that are **attractively priced**, in order to generate an average **annualized return on capital of at least 20%** perpetually with **adequate monthly cash flow**.

Principles and Guidelines

I) The aim is to peacefully try to be consistently not stupid and find no-brainer opportunities in equity and debt markets instead of trying to be very smart or investing in complicated theses. Decisions must be made rationally and practically rather than theoretically. An important aspect of not being stupid is to increase awareness of and mitigate cognitive biases. In order to not be stupid, one must keep an open mind that is mouldable and one has to keep reading, learning, seeing different perspectives and using mental models. Limiting information obesity, tuning out noise, and the number of decisions to be made also contributes to reduction in propensity to make stupid decisions. “Occam’s Razor” is an important problem-solving principle that states that, “Among competing hypotheses, the one with the fewest assumptions should be selected." Approach to investing must be as simplistic and minimalistic, with least number of decisions and complications as possible. In order to be not stupid, an investor has to be stoic and unemotional about his investments. An investor must ignore factors that are out of his control in investing. Focus, peace of mind and mindfulness are the fundamental pillars of being not stupid. Investment decisions are to be made only when the state of mind is comprising of all three of these.

In general, survival is the only road to riches.

- Peter Bernstein

II) A balance is to be maintained between equity and debt investments and between value investments and positional trades in accordance with macro-economic and market conditions.

III) Macro-economic conditions such as the interest rate, inflation, trade and money supply drive money flow and dictate the state of economy and business. Market conditions comprise of P/E, P/B, dividend yield, state and trend of indices that lead the tendencies of individual securities. Macro-economic and market conditions form the overarching context within which I must find opportunities for investing and trading. Markets, like all businesses, go through cycles and it is important to vary investment strategy throughout the cyclic market process of accumulation and distribution. It is prudent to get cautious
According to the level of the market, I will focus more on finding equity investments when there is a crash or a bear market as per indices and more on finding positional trading opportunities and stable returns through debt when there is higher relative valuation as per indices.

IV) Value investments are investments to be done with a 3-5 year horizon. Such investments would be in stocks of businesses that have one or more of the following characteristics:
  a. Are owned by relatively fair, intelligent fanatic promoters who are ethical about minority shareholders.
  b. A good potential for topline growth and are in profit expansion phase of business cycle.
  c. A developing competitive advantage and moat.
  d. Undertaken majour capex plans and are now to reap benefits of the capex through a favourable market.
  e. Are restructuring in an easy-to-understand manner that would result in value unlocking for shareholders.

f. Are in sectors undergoing a temporary downturn due to acute headwinds or ignorance of the market.
g. Are misperceived by the market due to unjustifiable rumours or overreactions in extremes.
h. Are debt free or have high interest coverage ratio.
i. Have a high unpledged promoter holding of above 50%, with an increasing trend in promoter holding.
j. Are boring and available at a discount due to market ignorance.
k. Are technically strong and are attracting big ticket investments.
l. Have a large sized order book and relatively large business visibility.
m. Of which I have reliable insider information.
n. Are presently unlisted but have one or more of above characteristics.

V) Positional trades are investments done from a trading perspective with a relatively short-term horizon of a few days to a year. Such investments would be done in stocks that display the following characteristics:
a. Are displaying a basic technical pattern that is reflective of repetitive market behaviour based on history.
b. Are undergoing a majour trend change with high volumes.
c. Are turning around from a trough in the business cycle.
d. Have a temporary business tailwind.
e. Are temporarily free from a business headwind.
f. Are in a sector that is receiving extraordinary market attention.
g. Are undergoing trend continuation with increased momentum in extremes.
h. Are being bought consistently by promoters.
i. Are in the process of being listed and are offered at favourable valuations.
j. Are recommended by proven people in inner circle of trust.

VI) Investments are outcomes of distributions of probabilities. In contrast to gambling where a gambler has no control over the probabilistic distributions, it is the objective of equity investing to find opportunities that have a probabilistic distribution that is favourable to investor. Keeping this in mind, it is possible that despite taking all precaution, the outcome of an investment might be unfavourable. Therefore, it is necessary to have a stoploss procedure and an exit plan for all investments. Stoplosses would be based on a percentage of the invested capital or based on technical patterns and trendlines. An exit strategy would be developed and implemented keeping in mind the change in the probabilistic distribution of outcomes.

VII) Fundamentally strong businesses are businesses that have a competitive advantage due to:

a. Network Effect: If the value of a good or service increases with the number of people using it, then the most valuable network based products will be the ones that attract the most users, creating a virtuous circle that squeezes out smaller networks and increases the size of dominant networks.
b. High Switching Costs: Businesses that have products or services where costs of switching to the competitor's products or services outweigh benefits.
c. Intangible Assets: Businesses that can create a good brand or have unique patents or have unique regulatory approvals have a significant competitive advantage.
d. Low/No Competition: Monopolistic or oligopolistic businesses that have strong pricing power and/or sell essential services or products.
e. Low Cost Advantage: Businesses where the company is the lowest cost producer. It is almost impossible for existing newer entrants to match the cost.

VIII) Investment opportunities are more likely to be found in companies or sectors that are currently disliked, are being ignored by the market or are just catching the attention of the market. Therefore, the focus is to find such companies and sectors that are currently out of favour in the mind of other investors.

IX) As a minority shareholder, I do not have any control over the business decisions. Therefore, an investment is equivalent to handing over of investor capital to the promoters and management of the business. Good promoters are ethical promoters that treat minority shareholders relatively fairly over the long term. Ultimately, successful businesses are those that are run by "intelligent fanatics", who are extremely passionate, intelligent and minimalistic about the business they are running. The quality of promoters can be judged by:

a. Studying composition of board of directors in terms of relatives, etc.
b. Comparing compensation as proportion of profits and trend of compensation.
c. Judging vision and attitude via interviews and commentaries.
d. Studying related party transactions.
e. Studying history of preferential treatment given to self in terms of warrant issues, etc.
f. Considering reaction of management to crises.

X) High promoter holding implies that promoters have a genuine interest in the business and an incentive to give their best to improve business performance. It is necessary to study the change in promoter holding, and shareholding in general, as a sign of future trend direction.

XI) A good business must be available at an attractive price. While valuation is a highly subjective field, some of the important business valuation tools and techniques are:

a. DCF: Discounted Cash Flow is a method of valuation of business that seeks to project future performance and discount it an appropriate rate. The simpler and conservative the projection model, the better the accuracy of the valuation.
b. Comparables: This method entails comparing a target company with competitors. An investor can get an idea about relative valuation based on this approach.
c. SOTP: Many companies have businesses in different verticals. The Sum of the Parts approach seeks to value these businesses independently and combine the valuations of these separate businesses.
d. Cash Flow analysis: It is important to undertake cashflow analysis to ensure that financials disclosed by companies are not cooked and can be trusted. Cash flow from operations must be positive and must match the net profit generated by the business over the long run. The net cumulative cash generated by a business must be positive for it to add shareholder value.

XII) Compounding is said to be the 9th wonder of the world and correctly so. More than the expected return number, it is important to achieve anti-fragility and consistency in returns over the long term of 40-50 years. I would like to generate a return of at least 30% per annum on my capital post-tax and inflation. Assuming a 15% tax rate and 5% inflation rate, I would have to generate a 20% gross return on my capital per annum to achieve my target. Just as it is important to define investment opportunities, it is also important to develop exit strategies to ensure long term survival in the capital markets. I would exit an investment if:

a. My thesis has played out.
b. The stock is not reacting to the thesis as expected.
c. New information has emerged that significantly contradicts the investment thesis or strongly undermines management quality.
d. The market index is showing signs of overheating and topping out.
e. The bond investment is not giving expected returns over a medium term.
f. Management has failed to deliver or shifted focus.
g. Valuation has reached an extreme.
h. Stoploss level has been triggered.

XIII) I have an important need for monthly adequate cash flow for meeting day to day expenses. This need is overarching and commands and limits the risk/reward ratio I am willing to take. Due to this need, I will be conservative in my investment style. I will manage my cash positions to ensure that I have adequate cash to meet contingent expenses and to invest in new opportunities. The primary portfolio currently will be in direct stocks and large cap mutual funds with tax benefit. As I grow older, a larger portion of the portfolio will be invested in fixed income and hybrid securities to meet the need for adequate monthly cash flows.