Year-end is often when things thankfully slow down for a while, and we can reflect on the past year’s tumultuous events. From trade wars and crude price volatility to liquidity squeezes, 2018 was a handful, and it kept us investors on our toes. Naturally, new lessons were learned, old truths were underlined and new perspectives reached. Here are a few things that I learned:

1. Correlation Between Hard Work and Results

Relentless hard work gets results is something that has been drilled into most of us. Not getting good marks? Study harder. Not losing weight? Sweat it out more in the gym. Sometimes this is where we make the Venn diagram mistake. Yes, good results require hard work, but there are times when hard work by itself does not guarantee success. During the volatile middle part of the year, I reacted to portfolio underperformance by giving it all that I had, so much so that eating right, working out, time with friends and family fell by the wayside. I need not have.

It was a time when the macro narrative was so dominant that individual stock picking (where most of the hard work gets done) was of little consequence.

* Simhavalokana is a Sanskrit term to denote the retrospective gaze of a lion. It is said that as the lion traverses some distance in the jungle, he looks back to examine the path he chose and how he covered that distance.

* A Venn diagram is a mathematical illustration of the relationships between and among sets or groups of objects that share something in common.
As Display 1 suggests, market performance was quite narrow in 2018. Only 18 out of the 51 NIFTY² stocks outperformed the index versus an intuitive average of about 25. We had a similar scenario in 2013 when macro worries dominated the market and individual stock picking took a backseat.

Within these narrow outperformers, the index heavyweights punched above their weights, and the only question that mattered for a relative investor was how much of these names did you own? (Display 2)

<table>
<thead>
<tr>
<th>SECURITY</th>
<th>MSCI SECTOR</th>
<th>MSCI INDIA WEIGHT (%)</th>
<th>JAN-SEPT 2018 PERFORMANCE (%)</th>
<th>WEIGHTED AVERAGE PERFORMANCE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reliance Industries Ltd</td>
<td>Energy</td>
<td>11.2</td>
<td>20.3</td>
<td>2.3</td>
</tr>
<tr>
<td>HDFC Ltd</td>
<td>Financials</td>
<td>8.7</td>
<td>-9.7</td>
<td>-0.9</td>
</tr>
<tr>
<td>Infosys Ltd</td>
<td>Info Technology</td>
<td>8.0</td>
<td>23.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Tata Consultancy Services</td>
<td>Info Technology</td>
<td>6.3</td>
<td>42.4</td>
<td>2.7</td>
</tr>
<tr>
<td>Axis Bank Ltd</td>
<td>Financials</td>
<td>3.4</td>
<td>-4.3</td>
<td>-0.2</td>
</tr>
<tr>
<td>Weighted Average total</td>
<td></td>
<td></td>
<td></td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: RIMES, MSCI, MSIM, Data as of 28 September 2018

3. Does Macro Matter for Stock Picking? Yes and No

In one of our earlier pieces, we wrote that macro does not matter for stock picking. We forgot to put a “Terms and Conditions Apply” asterisk there. The longer your investment horizon, the lesser is the relevance of the macro.
If you are like Warren Buffett—who is happy to hold on to stocks even if the market shuts down for 10 years—then you need not pay any attention to macro. However, if you stand in front of an investment committee every quarter, you better be paying heed to it.

This holds true for politics too. If your investment horizon is, say, the month of May 2019, a single event is going to matter for your performance. If your horizon is January 2019 to January 2029, you can afford to totally ignore what happens in May 2019. Display 4 shows NIFTY performance from Jan 2004 to December 2013. The period has two general election result days, and on both those days, the market was locked on 20% circuit breaker.5

### Display 4

**NIFTY—January 2004 to December 2013**

<table>
<thead>
<tr>
<th>NIFTY Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
</tr>
<tr>
<td>Jan 04</td>
</tr>
</tbody>
</table>

Source: Bloomberg, MSIM, Data as of 31 December 2013

However those violent reactions are but a small wiggle on the 10-year chart.

### 4. Impossible Trinity of Money Management

While the impossible trinity of macroeconomics is oft quoted, I discovered (the hard way) the impossible trinity of money management this year.

Concentrated portfolios, low turnover and short-term performance measurement are an impossible trinity.

If you run low-churn concentrated portfolios, you have little control over short-term performance. If you want to assert control over short-term performance with low churn, then you should run a quasi-index diversified portfolio (passive investing). It’s an untested hypothesis, but running concentrated yet high-churn portfolios may give you some control on short-term performance. Choose two, let go of the third.

### 5. How Portfolio Quality Dilution Happens

Most fellow investors I talk to utter the word 'quality' in the first two sentences when we chat about investment styles.

So if everybody is so quality-focused, how do low-quality stocks creep into institutional portfolios?

They enter mostly at the tail end of red hot rallies like 2017 when yes, you are quality focused but you are also valuation focused. The best in class stock in the theme that you like is trading at astronomical valuations and you go down the quality curve because you want palatable valuations. The added difficulty is at that time, there is a huge squad of motivated investment bankers and sell-siders cheering the next XYZ (fill in XYZ with your favourite unaffordable stock).

The lesson here is simple: try to gravitate towards best in class. If it’s unaffordable it may be worth waiting. Don’t settle for a look-alike. Genuine quality stocks are like tennis balls—they bounce back. Look-alikes are like eggs—they break.

### 6. Lessons From Tom and Jerry

Growing up, one of my favourite cartoons was Tom and Jerry, and I used to love the hilarious chases that Tom would routinely undertake. One that drew most guffaws was when Tom would keep running in air after the end of a cliff and then fall down in a straight line. That happens to markets too.

They can overextend after the underlying fundamentals have turned, as if running in air. That happened when markets kept rallying hard until January 2018 despite the fact that, as mentioned above, the macro story had clearly turned downward. This happens on the other side as well when markets and stocks just ignore fundamental improvements, and it can be quite frustrating for an investor.

But the lesson here is to stay with your fundamental convictions. Even Tom could not defy gravity.

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5 A circuit breaker for an index is a financial regulatory instrument issued by the Securities and Exchange Board of India (SEBI) to prevent extreme volatility in the market caused by a specific event. The idea is to halt trading for a certain period of time and allow the market to cool down and return to normal levels. According to SEBI, a 20% circuit breaker is the one which is applied to an index if it deviates by 20% at any point of the day; the trading in this case remains closed for the rest of the day.
7. Volatility and Productivity

Recently, I activated the Screen Time feature on my phone. It measures the amount of time you spend on your phone and sends you a summary at the end of the day. Without giving you details, let me just say I have been disgusted at the amount of time I have been spending on the phone. I think even Bloomberg terminal should have this feature especially on volatile days. Things are moving all over the place, the screen is hypnotic, and you sit in front of it immobilised or worse, succumbing to negative thought spirals that through one route or the other take you to the impending end of the world. And just like that, it’s 3.30 p.m.

Avoid getting sucked in by the spiral by planning your circuit breaker in advance; anything that forces you away from the screen.

Personally, I lock away the phone, gather a bunch of piled-up reading and relocate to the coffee shop below our office building. In a place full of financial services firms, the coffee shop is generally deserted on such volatile days.

8. The Greatest Enemy of Growth Investing

The greatest enemy of growth investors is de-rating, i.e. when markets opt to pay a lower multiple than before for the same earnings stream because it views current growth to be unsustainable. If predicting earnings and cash flows is the science of investing, then predicting the multiple that the market will ascribe to it, is the art. It involves understanding the narrative around a stock or sector and what the market collectively feels about its future. At times like these, when disruption is a buzz word, stress testing the high-growth companies in your portfolio for vulnerability from disruption, either real or perceived, is important.

A simple question that I ask myself in these situations is whether next three years are likely to be higher-growth years or lower-growth years than the last three?

If you get this right, you will most likely get the multiple right.

9. How to Survive Underperformance

In an earlier essay, I wrote about how a fund manager can cope with portfolio underperformance.

The key there is to be clear about one’s investment style and state in advance what kind of market environment the portfolio will do well and badly in.

We typically express this with the following bell-curve chart, and there was a learning there as well. Most of us learn to see the world map in two dimensions. As a kid, it took me a while to understand that you can reach Hawaii quite quickly from New Zealand and you don’t actually have to fly westwards all the way back. As an investor, it took me a while to understand that you can get to ‘Batten down the hatches’ quite quickly from ‘Off to the Races’ (Display 5).

DISPLAY 5
The Performance Bell Curve

<table>
<thead>
<tr>
<th>Market returns</th>
<th>-50%</th>
<th>-20%</th>
<th>+20%</th>
<th>+50%</th>
</tr>
</thead>
</table>
| Defensive sectors | *Sweet spot for the Portfolio* | "Batten down the hatches" | "Off to the Races" | "High beta rally"
| Source- MSIM |

10. ‘Comfort Zone’ Is Not Always a Bad Thing

With the advent of performance culture that extends from sports to the corporate world, ‘comfort zone’ has become a bad word. It has become something that has to be avoided at all costs if you don’t want to fall behind in life.

But in a trying year like 2018, it’s extremely important to have cultivated a comfort zone.

A place or a routine, that gives you a sense of calmness, helps you put things in perspective and rise above the pushes and pulls of daily life to see the bigger picture. It’s a place you come to recharge your batteries and be a bit easy on yourself. There is a small temple close to where I grew up that thankfully hasn’t made it to ‘Top 10 places in Mumbai if you are seeking divine intervention’. On days, which aren’t the favourite of the presiding deity, it’s quite empty. It’s on such days, sitting cross-legged in the cool inner sanctum, that I have been able to quieten the mind. Once in a while, I have also remembered to fold my hands and pay obeisance.

We value the lessons we have learned because they make us better stewards of our clients’ capital. As we head into 2019, we expect lingering market volatility to keep us on our toes. We will be keeping pace with evolving markets, anticipating new opportunities and challenges without losing sight of the old, unchanging truths.

Wishing you a great 2019. Happy investing!

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DEFINITIONS

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. Growth at a reasonable price (GARP) is an equity investment strategy that seeks to combine the principles of both growth investing and value investing to select individual stocks. NIFTY 50 Index is the National Stock Exchange of India’s benchmark broad-based stock market index for the Indian equity market. It is a float-adjusted, market-capitalisation weighted index and consists of the two main stock indexes used in India.

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