Connecting the Dots

What Not to Do When Investing

Each year, new books appear on the shelves that promise to reveal the secrets to successful investing. But the irony of such yearly publications is clear: the ultimate guide to successful investing has yet to be written. In addition to the slew of books, there is an epidemic of listicles these days that claim to offer the habits of successful investors for you to emulate. For instance, all top investors are early risers and voracious readers are frequently cited, as if waking up at the crack of dawn and reading tomes is all it takes to enter the legion of billionaires. While all this self-help literature overwhelmingly focuses on what to do for that elusive investing success, there is scant information on what *not to do*. As practitioners, we believe what you do not choose is equally, if not more, important to your eventual investing success.

Before we get into the list of "avoids," like in any linear programming problem, it is important to define the objective function. Here we are optimizing for superior long-term investing outcomes for a stock picker. *Superior* equals "comfortably better than inflation," *long term* is longer than one full business cycle, and *stock picker* is a person interested in individual stocks.

AUTHORS

AMAY HATTANGADI
Managing Director
Morgan Stanley
Investment Management

SWANAND KELKAR
Executive Director
Morgan Stanley
Investment Management

1. The Meaningless Aggregates

Every time we make a public appearance as investors, we make sure to cram up on the following: Price-Earnings ratio, headline GDP numbers and its constituents and market capitalization to GDP. The reason for this is we know there will be questions on these things, and since we do not care about these metrics in our day-to-day investing, our memories have to be refreshed. We also pay scant attention to country weights in global benchmarks. However, what tickles our funny bones the most are index targets from myriad experts. Ralph Wanger in his book, "A Zebra in Lion Country,"[1] put it succinctly clear to us decades ago: "If you believe you or anyone else has a system that can predict the future of the stock market, the joke is on you." Although funny in a Wanger way, we take this line very seriously.

2. The Binary Global Macro

We conducted a poll among our investor and analyst friends, who said *macro* was at the top of their ignore list. Now, the term macro is sort of a catchall, and can mean several things to different people. Understanding and appreciating the macro regime in which one operates is important, but what long-term stock pickers should ignore are events that are made out to be binary in nature—if it goes this way we are "off to the races," but we get clobbered if it goes the other way. Current Exhibit A for this is the U.K.'s Brexit decision. We do not have the foggiest idea of what is going to happen, and we really do not care. Our preferred approach is to use these macro dislocations to get in or out of stocks at price levels that we like.

3. Flows

Market participants obsess over the source and type of money that flows into the market. As we had written earlier, there is a small cottage industry of people who try to predict which stocks will get into which indices and will result in what quantum of passive money flow. People also religiously check block and bulk deal information, or try to cajole information out of broker friends to find out who is buying and selling what. As fodder to the voyeur inside, this is fine but treat it like watching an episode of "Big Brother"[2]—just as that does not affect your life, neither should this affect your investing.

When we were newbies in the market, new words that got added to our vocabulary were "overhang" and "degrowth." Although we were quite familiar with the word hangover, we did not know that "overhang" meant a possibly large seller in a stock because of who the stock price is under pressure. When going through old notes, we laugh at how we described such overhangs as key risks while over time they did not matter one bit.

4. Sell Side Shenanigans

Our inboxes get mauled every January with investing strategies for the new year (in a game of one-upmanship, this activity starts in November these days). We do not think stocks and underlying businesses care for the fact that the calendar year has changed. Neither do they care for analyst recommendation upgrades, downgrades, changes in target prices, bonus issues or stock splits. You should not either.

5. Esoteric Distractions

Delhi-watching is another favorite pastime of the chatterati. What policymakers are doing, likely to do, not doing, not likely to do occupies prime mental space. State elections, coalition math, truant weather and tax treaties are interesting party conversations, but do not let these topics pollute your investing process.

Separately, while caring for the minority shareholders is an important attribute, minority-friendliness is often confused with the number of TV appearances of the Chief Executive Officer. That by itself has no bearing on long-term stock price performance. One of the best performing stocks in our portfolio is a multinational company in the auto ancillary space, and in the seven years that we have held the stock, we have not seen the CEO even once on TV.

It is difficult to summarize all the nonessentials in one article, but our guiding principle is neatly captured by Paul Samuelson—"Investing should be more like watching paint dry or watching grass grow. If you want excitement, go to Las Vegas." Suffice to say, anything that triggers the same tingle of excitement as the dying revolutions of a roulette wheel, is not investing.

[1] Ralph Wanger (1997). *"A Zebra in Lion Country."* New York, Simon & Schuster.
[2] Reality game show franchise produced by Dutch media company, Endemol.