MONEYLIFE ADVISORY
MAS WEALTH

Maybe.

Dear Subscriber,

Let me start this letter with an interesting story Taoist story. I read it in an investment letter, but can apply to any aspect of our lives. It's about drawing conclusions from an immediate and small set of facts. Here goes the story. One day an old farmer's horse ran away. Upon hearing the news, his neighbours came to commiserate. "Such bad luck," they said sympathetically. "May be," the farmer replied. A few days later the horse returned, bringing with it three other wild horses. "How wonderful," the neighbours now exclaimed. "You are so lucky." The old man replied: "May be."

A few months later, his son tried to ride one of the new horses, was thrown off, and broke his leg. The neighbours came again to offer their sympathy on his misfortune. "This is terrible. It is such a bad omen too," they said. Again the old man answered: "May be." A few days later, war broke out and military officials came to the village to draft young men into the army. They did not bother about the farmer's son's who was laid up on the bed with a broken leg. The neighbours congratulated the farmer on how well things had turned out. "May be," said the farmer.

The farmer's story is, of course, fictional. But the lesson is clear: the neighbours were repeatedly wrong in their conclusions, like we often are, since they based their conclusions on immediate and single instances. Some outcomes can be known only later. As we move out of a year like no other in living memory, we have seen the Taoist story played out in stockmarkets.

I can relate to the parable well. When we opened our portfolio management services in December 2019, after months of delay, someone told me, "this is a good time to build a portfolio." Three months later, in March, the market was crashing. Then, someone else sympathetically asked: "Don't you wish, you hadn't launched PMS now?" It certainly looked like the worst time to launch a PMS. May be. However, the market stabilised in April and started rising from May. An investor who joined in March 2020 has got the best return among all. Some stocks we picked up, shot up. Has it all turned out very well? Yes, for now. Or, rather, may be. The lesson is simple: one, it takes time to understand the true implications of any phenomenon and two, our conclusions (and forecasts) are often wrong because we are not good at understanding all the implications of a situation. But we do have an irresistible urge to make sense of it instantly.

A Year Without Precedent

This propensity often gets combined with another —we rarely learn from history. George Santanaya said, "Those who cannot remember the past are condemned to repeat it." In the market the past does not repeat. How about Mark Twain's comment then? "History never repeats itself but it rhymes"? I used be in this camp but let's see what happened in 2020. Within the same year, the Nifty hit a low of 7,511 in March and high of over 14,000 in December. Well, this was not the past repeating itself. This time, it didn't even rhyme.

The market has never recovered from big market crashes so quickly – whether in 1992, 2000 or 2008. The same is true of international markets. And this time, the external situation was much worse. Due to Covid-19, there was a synchronized global economic, social and health crisis. Nobody knew anything much about the virus. Life itself came to a halt. Small businesses were decimated. Large businesses said that they were flying blind. If you asked someone in April, May and June, the market had stabilised but this was said to be a lull before the storm. Growth had come to a halt all over the world. Every commentator (including myself) feared that there was worse to come. But miraculously, from extreme gloom and doom, the market rallied, and how!

Within six months, from extreme despair, the market became bullish and then in the next three months, super bullish. What is the explanation for the stock market hitting a record high during an economic recession? Even with the benefit of hindsight, it is impossible to explain how the market revived so quickly and so much. It seems a mysterious and surreal.

In markets, if you remember the lessons of the past too well, you will miss the live lesson the market is trying to teach you. The deeper lesson is this: we have an illusion of knowledge. We think we know what determines stock prices – one, factors that influence the macroeconomic environment and two, factors that influence specific stocks. If the macro is bad but business is good for a specific sector, there will be winners from sector. But in 2020, not only was the macro environment the worst ever in living memory but earnings have collapsed too – at least they did in the first half.

If we cannot explain something, even with the benefit of hindsight, we say the market discounts the future. This can be used to explain all that cannot be explained. An illogical rally? The market is discounting the future. A bear market with prices languishing? The market is expecting worse to come. Obviously, like the farmer's neighbours, we are eager to describe a phenomenon as it happens. Humans have a strong itch to make sense of the world around them on a minute-to-minute basis and so we deploy the 'discounting the future' argument – after an event has happened.

Looking back, two kinds of people made money in the extraordinary year that was 2020. First, those who quickly exited in early March and then got back to the market when it stabilised (these were extremely rare). Second, those who did nothing to their portfolio and waited. This applies to the vast majority, including mutual funds. They now feel vindicated, convinced that they had the right strategy to 'hold' through the crash. But we believe that they were just frozen, like a deer, caught in the headlights. We too did not make much of a change to our portfolio, but we do not feel vindicated. Have things worked out well? Maybe. Will the market go down again, as some think it will, just when everyone has turned fully bullish? May be. We would continue to follow our strategy of a) Staying focused on quality stocks b) applying our timing model on them.

Debashis Basu,
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