MONEYLIFE ADVISORY

Letter From the Founder

What is our "story"?

Dear friends,

It gives me great pleasure to welcome you to Moneylife Wealth, the portfolio management services (registration no: INP000006873) of Moneylife Advisory Services. There are hundreds of PMS firms. So, why have we entered this field? We believe we can add value to your wealth under four critical parameters: Returns, Drawdown, Volatility and Churn. This means we hope to give good returns over the years; lose less in bad years; keep your portfolio from jumping up and down much, and will not buy and sell much. You are probably telling yourself, 'this is what everyone claims. How will MAS Wealth ensure these noble objectives?'

Hardly anyone expressly creates portfolios with low volatility, even though academic studies show a correlation between lower volatility and higher returns -- not to speak of peace of mind that lower volatility brings. The conventional assumption is that equity is volatile and investors have to grit their teeth and ride it. While equity is certainly volatile by nature, to not even attempt to reduce the volatility of a portfolio is a lazy way of managing money, perhaps amounting to avoiding fiduciary responsibility. This is one of many unsavoury practices we have imported from Wall Street. We want to follow a different path.

Limitation of Knowledge

In stock picking and portfolio construction, we take a different approach. It starts with circumspection, a realisation about the limits of our knowledge as outside investors. Equity market participants, especially those who handle other people's money, are usually very confident people. They also place a lot of faith in what managements, policy makers and officials say. We, however, assume that we suffer from severe limitations:

- **We don't control anything:** Returns are a function of corporate earnings and market prices but no one has any control over either.
- **We don't know enough:** As for corporate earnings, as outside investors, we can never know enough. This is why analysts rely on management guidance. But then why are earnings and governance surprises so common? Managements lie and fudge too.
- **Managements can be clueless:** Even when managements don't fudge, they themselves can be clueless. Companies plan large expansion just when a cyclical downturn is around the corner. Or, massively overpay for acquisitions. Yes, managements can be clueless about their own affairs.
- **More knowledge = higher returns?:** One way to overcome the above limitations is to put additional effort in knowing more: meet competitors and suppliers; dig deeper into data on raw materials, sales, expenses and other line items; meet the managements; listen to concalls, parse data for insights on customer behavior etc. But does deeper knowledge mean higher stock returns? If yes, why would there be a huge variation in returns between two equally large teams of mutual funds or PMS, who are all equally competent and working hard and deep. After a point, there can even be a diminishing return from additional knowledge about a company. You can miss the wood for the trees.

The farce of DCF: Calculating the intrinsic value of a company by discounting cash flows (DCF), is an article of faith among institutional investors and analysts. We spare ourselves the trouble. The reason is the same as above: we don't know enough. When the outlook for the next year itself is not clear, how can one estimate cash flows for the next 10 years? And when the outlook is clear, it offers such enormous comfort that the stock would be in everybody's portfolio and hence, it would be overvalued. The market pays a big premium for comfort, consensus, certainty and clarity, which may leave little room for future gains.

Significance of price: As for market prices, portfolio managers don't pay much attention to price trends. Interestingly, the only data points that determine your investment returns is the price at which you buy and sell. We assume that the market collectively knows more than us, a wisdom that is usually reflected in price trends.

Valuation in action: Portfolio managers claim to pay close attention to valuation. So, how do so many of them pay irrational prices for irresistible "stories", or buy grossly overvalued stocks at market peaks, especially if such stocks are part of benchmarks?

The Lure of Stories: Most attractive investment research talk of stocks being part of "themes", "stories", "megatrends" and "turnarounds." These catch on, because human beings love stories. But the market does not care about our stories. Stories are not correlated with future stock returns.

Scepticism is a Virtue: It is said that to make money in the market you need to have a positive frame of mind. If this means a mostly bullish, 100% invested position then returns will be poor. It is easy to be positive with other people's money. Being positive can mean being naïve too—look at the amount of money institutional investors and famous individual investors have lost in stocks that there were positive about turning around. Having known hundreds of businessmen, policy makers, institutional investors, officials, and having analysed what really works in the market, we believe that scepticism is a virtue. This is because, in markets, we are dealing with promises, statements of intent, projections, price targets etc., which have a low strike rate.

Algorithm + Experience

So, what do we bring to the table that is unique? The returns from stocks are a complex interplay of market, economy and corporate performance. We believe there is a lot of scope to apply the classical "scientific method" to investing: observation, hypothesis, measurement, and modification of hypotheses. As is obvious, the heart of this scientific method is data. We believe data is supreme; data does not lie. Anything else is subjective, distracting and even misleading. And, as my observations above (bulleted points) show, there is plenty to distract and mislead us.

We have observed what has worked in the past, created a hypothesis, measured its probability of success, and look to applying it in future. It is an algorithm, but not bound by a hard and fast rule. Unlike physical systems, markets are emergent, complex, social and adaptive systems that are not bound by strict laws and theorems. But investing is not about getting it right every time. It is about getting it right more than not. The odds of success are certainly increased by following a method.

We supplement this algorithm with decades of experience and personal knowledge of the Indian corporate and the market ecosystem comprising businessmen, officials, politicians and regulators. If we have managed to duck almost all major cases of misgovernance in the last seven years of stock picking for our stockletters – DHFL, Yes Bank, Vakrangee, Anil Ambani group companies, Zee, Manpasand Beverages, infrastructure companies, public sector companies etc. -- it is because of this algorithm, combined with our deep knowledge and experience of the Indian ecosystem. This is the value that we bring.

We eat our own cooking

We are launching two schemes. The first one, called Growth, is ideal for those who have at least 10 years of investing ahead. The second one, called Prime, is for a combination of growth with wealth preservation. This would be ideal for families, businesses and professionals looking to invest surplus cash or those keen on wealth preservation along with appreciation.

These two schemes should meet the needs of almost all investors. A substantial portfolio of MAS directors and shareholders are in our own PMS schemes.

Finally, some mundane but important housekeeping stuff. You are, of course, aware of the merits of PMS. Investments are managed on an individual basis and your money is safe with a third-party custodian – in our case Kotak Mahindra Bank. The custodian safeguards your assets from all systemic risks. It directly controls the funds / securities in a fiduciary capacity. Brokers, depository participants, banks, advisors, us – no one can access your assets.

The custodian will ensure reconciliation of accounts and will track, report, realise, reconcile corporate actions such as dividends on your assets and support right issue, buy-back if any. You will get performance reports on a monthly basis, along with transaction, holding & corporate action reports. You will get an annual statement of account for you to file your taxes. We provide web access for portfolio tracking.

If you have any questions, I would be happy to answer. Just send me an email. We will be proud and pleased to manage your money.

Safe and happy investing

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