Portfolio performance

The since-inception (June 2019) TWRR for the PMS is 16.2%. This compares favorably with our benchmark Nifty that returned 13.6% over the same period. Our standard deviation is almost at the same level and CAPM beta is well below that of the benchmark and our Sharpe ratio is well above, as detailed in the factsheet.

Our monthly factsheet can be downloaded here.

Markets update

Markets across the globe saw a sharp rally. Dow was up 14% and most global markets bounced back from key technical supports. Only exception was China that saw sharp correction due to political worries and continued lockdowns. Indian markets fared well as FPIs continued to be net buyers. Quarterly earnings, especially from large companies, were better than expected. The macro data continues to show improvement.

Markets have defied the popular analyst opinion of a sharp correction due to high inflation and tightening of liquidity. While global central banks, led by US Fed, are expected to continue to raise rates to tame inflation, there is a growing belief that the pace of these increases will slow. Risk assets, including equity, are under owned globally and are seeing a sharp uptick as investors rush in to benefit from beaten down valuations.

Indian markets have performed quite well amidst this global volatility and long-term investors are once again rewarded for staying the course. Investors who used the sharp sell-off in May and June to add to their portfolio have done even better. Indian markets are close to all-time high. Once again this shows that predicting the direction of the market is an exercise in futility. As a long-term investor, all that one needs to do is to create a portfolio of high-quality growth companies and then stay invested through the market cycles. More on that in the last section of this letter.

Portfolio update

We completely exited Info Edge last month. We had the company in our model portfolio for a long time and it has generated excellent returns for us. However, our valuation models started flashing red recently. The current valuation of the company is not supported by its only profit-making business - Naukri.com. All other properties, including Jeevansathi.com and 99acres.com continue to lose money. Investments in Internet companies Zomato and PolicyBazaar have lost significant value as they have not been able to articulate a clear path to profitability. The market valuations of money-losing Internet companies have taken a big beating globally, and it will have a bearing on these companies. Earlier, in our valuation model, we were assuming that these properties will become profitable over the next couple of years. However, as soon as we changed that assumption, the fair value of Info Edge fell to a level where we believe that it will be better if we fully exit it from our model portfolio.

We have replaced it with a small private bank. This bank has a very long history and has very sticky and high-quality deposit base. It had run into problems of asset quality due to loans made to below prime companies. The bank got a new CEO (ex-ICICI Bank) a couple of years back and has turned around its asset book. We have been tracking the performance of the bank for last one year and got the confidence to add it to the model portfolio after the latest quarterly results that showed remarkable improvement across all metrics. This includes high profitability, improvement in asset quality and CASA. The bank is trading at less than half time its book value which gives us ample margin of safety and possibility of an upside. There are still some unresolved loans in the legacy asset book. We would like to see the resolution of the same before we increase our weightage in the model portfolio from the current 3%.

Our cash position at PMS level is at 6.5%. We are not expecting any significant portfolio churn soon.

Futility of Making Forecasts related to markets

The industry of investment management has bred a sub-industry of making forecasts. These forecasts are in-your-face across financial media. It is amusing to see this industry flourish even though it has a very low success rate. We would like to share with you our thoughts on the futility of making forecasts.

We are going to quote extensively from the seminal book "What Works on Wall Street" by James P. O'Shaughnessy. This book is remarkable in its use of studies and data to make its points. We have liberally copied text from the book with due credit to the author and have interspersed the content below with our emphasis and comments. Here we go.

According to Barton Biggs's book Wealth, War and Wisdom, there is ample evidence that so called experts making intuitive forecasts are *right less than half the time* and that "they were worse than dart-throwing monkeys in forecasting outcomes when multiple probabilities were involved." And the study he was referring to did not use a small sample—it covered 284 experts who made 82,361 forecasts over a period of many years. The book concluded that most of these errors were made because analysts made decisions using intuitive, emotional heuristics. Biggs is not alone—in his book Value Investing: Tools and Techniques for Intelligent Investment, James Montier writes: "One of the recurring themes of my research is that we just can't forecast. There isn't a shred of evidence to suggest that we can. This, of course, doesn't stop everyone from trying. Last year, Rui Antunes of our quant team looked at the short-term forecasting ability of analysts. The results aren't kind to my brethren. *The average 24-month forecast error is around 94%, the average 12-month forecast error is around 45%."*

Most investors, as well as anyone else using traditional, intuitive forecasting methods, are overwhelmed by their human nature. They use information unreliably, one time including a stock in a portfolio and another time excluding it, even though in each instance the information is the same. Our decision-making is systematically flawed because we prefer gut reactions and individual, colorful stories to boring base rates.

Psychologists have shown in numerous studies that when people are confronted with vast amounts of data, their brains create mental shortcuts to make decisions. These shortcuts, called heuristics, are the rules of thumb on which most intuitive forecasters rely when making any number of complex decisions or forecasts in their field.

In his book Behavioral Finance: Insights into Irrational Minds and Markets, James Montier writes: This is the world of behavioral finance, a world in which human emotions rule, logic has its place, but markets are moved as much by psychological factors as by information from corporate balance sheets...[T]he models of classical finance are fatally flawed. They fail to produce predictions that are even vaguely close to the outcomes we observe in real financial markets...Of course, now we need some understanding of what causes markets to deviate from their fundamental value. The answer quite simply is human behavior.

David Faust writes in his revolutionary book, The Limits of Scientific Reasoning, that: "Human judgment is far more limited than we think. We have a surprisingly restricted capacity to manage or interpret complex information." Studying a wide range of professionals, from medical doctors making diagnoses to experts making predictions of job success in academic or military training, Faust found that human judges were consistently outperformed by simple actuarial models. Like traditional money managers, most professionals cannot beat the passive implementation of time-tested formulas.

In Praise of Discipline and Perseverance

Knowing and doing are two very different things. As Goethe said, "In the realm of ideas, everything depends on enthusiasm, in the real world, all rests on perseverance." While we may intellectually understand what we should do, we usually are overwhelmed by our nature, allowing the intensely emotional present to overpower our better judgment. As the Mahabharata says, everyone knows that the right thing to do is, but it is extremely difficult to actually do it.

In one study led by researcher Baba Shiv of Stanford University originally reported in a Wall Street Journal article titled "Lessons from the Brain-Damaged Investor," a group of 41 participants played an investment game in which each was given $20 and asked to make 20 rounds of $1 investing decisions based on a coin toss. The results were illuminating. Those participants without any emotional brain damage *invested just 58 percent of the time*, ending up with an average of $22.80, but participants with brain damage did much better, *investing 84 percent* of the time and ending up with an average of $25.70.

Dear investor, markets prove again and again that it is best to ignore the daily gyrations and stay invested across market cycles to create long term wealth. Discipline and perseverance are in short supply and if you have them, you have already won the battle. Data shows that most of the returns in the markets are made on less that 5% of trading days. So if you are out of the market on most of those days you would underperform the markets. Rather than timing the market it is best to focus energy on analysing highly rewarding long-term investment opportunities. Especially in case of India, investors are already at the right place at the right time for the next decade. All one needs to do is to stay invested.

Update on Piper Serica Angel Fund

We are very happy to inform you that our start up fund has started investing. We invested in 2 companies last month – Alt Mobility (www.alt-mobility.com) and Crediwatch (www.crediwatch.com). Both are very exciting young companies run by a great set of founders. Both companies rated more than 80% on Yoda.ai, our proprietary screening tool based on AI/ML. We have made commitment to invest in 4 more companies. These investments should close over the next month. We are excited to see some really good investment opportunities. The Angel Fund management team has expanded with addition of a senior person. This gives us incremental bandwidth to explore a larger number of investment opportunities.

The Angel Fund is still open for subscription for a limited period. In case you would like to subscribe or know more please contact Chirag Goradia on +91 96647 73757 or on Chirag@piperserica.com.

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