THE STOIC INVESTOR

REALIST | RESILIENT | RATIONAL

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By Nimesh Chandan

LIGHTHOUSE

In 2011, I asked my office to create a large acrylic board for me to put up on the wall near my desk. I chose a few words of wisdom from the investors I admire and put them on that board. In the center, I stuck a picture of a lighthouse. A lot of my colleagues were quite curious about the choice of this particular picture. I explained to them (quite proudly) that this board is my lighthouse. When ships are lost at sea, the lighthouse is a beacon light that guides them to their right course. In a similar way, when my mind is agitated by the noise of the market, when I can't see things clearly, this collection of quotes will guide me back to my investment path. And over the years, it indeed has.

One of the most prominent quotes in that pool of wisdom is:

"Traditionally, the investor has been the man with patience and the courage of his convictions who would buy when the harried or disheartened speculator was selling. If the investor is now to hold back until the market itself encourages him, how will he distinguish himself from the speculator, and wherein will he deserve any better than ordinary speculator's fate?"

– Benjamin Graham

I found this quote many years back when I read "Security Analysis" by Graham and Dodd. This is part of the introduction that was written for the second edition of the book, published in 1940. Clearly, investing behavior hasn't changed much. Even 80 years ago, the question and pressure of market timing received as much importance as it does today. Investors have been attracted to taking buying and selling decisions based on the right time rather than right price. To that end, people endeavor to forecast the market movement over the short term. An investor is supposed to be a person who studies securities in pursuit of acquiring and holding good businesses at the right prices. If

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Some people call themselves "short term investors". That phrase is an oxymoron, just like 'exact estimate' or 'act naturally' (or 'happily married' … haha). An investor can surely take advantage of the market fluctuations but that is based on the attractive price levels determined through proper analytical framework. As it is most commonly advised, be greedy when people are fearful. But to implement this advice in practice, one needs to be equipped with knowledge about the business one is buying as well as the temperament to stand against the crowd.

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BUYING WHEN THE MARKET TUMBLES

"Opportunities come infrequently. When it rains gold, put out the bucket, not the thimble." **- Warren Buffett**

In the last three decades, Indian markets have, every few years, given an opportunity to invest. There has been a sharp fall in the market for diverse set of reasons; from political events to financial troubles epidemics. Despite these previous falls, and the current one too, the long term returns for equity has outperformed returns from other investments and also inflation. Corrections or bear market falls give opportunity to increase exposure to good companies. Sure, sharp corrections come with crisis and fear. But as the old adage goes, 'Never let a good crisis go waste'. Widespread fear creates opportunities for investors. When people are fearful, their actions become based on emotions rather than logic or data. People become extremely risk averse, they panic, and they sell their holdings to a point where the prices incorporate the risks completely. Most of the times, panic incorporates risks that have a very low probability of occurrence. The most profitable opportunities to increase investments come during such downturns. The seeds of wealth are sown during downturns and fruits of the efforts are harvested during good times.

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Most businesses are cyclical. Good businesses often run into temporary troubles. Typically, their share prices fall as shareholders who are looking at short term results, exit. An investor equipped with patience and conviction can use these times to accumulate future winners and put a good amount of capital to work.

In the recent decades, there is a rise in the money managed passively or through quant models. They sell indiscriminately when they suffer redemptions, or their models trigger a sell. One also finds a large number of leveraged players in equity markets. They become forced sellers if there is a margin call which goes unfunded. All these come as opportunities for a prepared investor. These are the times when an intelligent investor stands out from the crowd and takes advantage of the overreaction.

YOU WON'T CATCH THE EXACT TOP OR THE BOTTOM

Extreme market movements are result of herd behavior. The crowd oscillates like a pendulum between manic highs and depressive lows. It is difficult to fundamentally measure the exact top and bottom of the market. Hence it is futile to try and catch the exact time when market peaks or troughs. Investors have to accept and accommodate the risk that markets can go lower even after they bought securities at attractive prices. An intelligent investor needs to be an intelligent risk taker.

Taking a contrarian stance doesn't always feel comfortable. But markets have shown that what is comfortable is rarely quite profitable

One cannot ask for absolute certainty about anything in the financial markets, one has to learn to deal with probabilities. History has shown that after a sharp fall like the one we are experiencing currently, the odds of making good returns on new investments go up. Taking a contrarian stance doesn't always feel comfortable. But markets have shown that what is comfortable is rarely quite profitable. Even if you make the right investments, the market may not reward you immediately. Being right doesn't mean the stocks you buy will move up the next day. To increase the odds of catching the best prices, one has to a) increase the portfolio evaluation time b) stagger the investment through the fall. Increasing portfolio evaluation time is nothing but having a long-term horizon but without short term reviews. Frequent portfolio evaluations lead to myopic loss aversion and act as a psychological barrier to investing. Staggering the investment will give margin of safety and provide for any mistakes in evaluation. It is also psychologically quite comforting to the investor.

To realize the returns of a good analytical framework and good temperament, the investor will need patience. Patience is the critical difference between an investor and a speculator

LOVE THE BAD TIMES

Good times teach only bad lessons: that investing is easy, that you know the secrets and that you don't need to worry about risk. The most valuable lessons are learnt in tough times – Howard Marks

In 2008, I wrote an email to my team with the title "I love the bad times". The central idea of the email was that there are many characteristics of a market crash that work well for the investors. Companies with substandard fundamentals enjoy good valuations during bull markets in what can be called a 'dash to trash' rally. These companies go back to their deserved valuations during a crash. Their share price movement is distinguished from those of good businesses. A stock market fall benefits investors who work on a good investment process. Frothy valuations and creative valuation techniques gets exposed. In a falling market, there is enough time to evaluate companies thoroughly rather than rush to buy. Why would an investor not welcome this kind of an opportunity every few years? All there is to investing is picking good stocks at these times and staying with them as long as they remain good companies.

A NEED FOR OPTIMISM AND PATIENCE

Being a good investor requires a dash of optimism too. While investing in good businesses too, one needs to be positive about the future and believe in a better tomorrow. There are many businesses in India have a strong business model, a good management team, limited capital requirement, healthy cashflows and a huge runway ahead of them to grow profitably. As a basket these businesses will be worth much more in future and will create huge wealth for shareholders.

Markets are not efficient, and people react with greed and fear. These conditions do not ensure that the investor will do well in equity investing. But these conditions are definitely raw material, or opportunity that an investor can use for successful investing. To realize the returns of a good analytical framework and good temperament, the investor will need patience. Patience is the critical difference between an investor and a speculator.

"There is a need for patience if big profits are to be made from investment. It is often easier to tell what will happen to the price of the stock than how much time will elapse before it happens."

- Philip Fisher

NIMESH CHANDAN
HEAD – INVESTMENTS, EQUITIES
CANARA ROBECO

Nimesh Chandan is Head-Investments, Equities at Canara Robeco. He has almost two decades of experience in the Indian Capital Markets. Nimesh has been with Canara Robeco since 2008 and in his current role, he guides the equity team in providing a strategy for various equity funds. He is a keen follower of Behavioral Finance and has developed tools and processes which help improve the investment decision making process. He also conducts workshops wherein he presents the concepts of Behavioral Finance to investors and financial advisors under a series called 'The Money and the Mind'.

ABOUT STOIC INVESTOR:

The word "Stoic" is used to describe someone who remains calm under pressure and avoids emotional extremes. For the purpose of this newsletter we refer to the "Stoic investor" as an investor who is realist (avoiding extreme optimism and extreme pessimism), resilient (withstand difficult conditions) and rational (who acts with logic and reason).

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