

How much I invest into my really high-conviction ideas



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Recently, one of the large banks which distributes our products asked for the reasons or narratives behind why we have bought certain stocks or exited them. Plus, they wanted to understand our top high-conviction ideas.

The issue we faced?

Why I deliberately avoid stories about the stocks I hold

First Global's entire investment process is anti-storification and anti-high-conviction – deliberately, consciously and systematically so.

All studies and data have shown that while human beings love stories, one of the systematic biases that bring down investment returns is storification.

It is a trap that all of us are very prone to, because stories are, in a real sense, what make us human.

In fact one of the only things common across all human civilizations across the ages and across geographies is storytelling.

Humans communicate by means of stories. We remember stories, we are moved by stories and we teach through stories.

That is why all ads from those selling toothpaste to those asking you to fund a charity are all stories. The most stark data like a x lakhs of children facing malnutrition does not move us the way a picture of video of a single starving child or family does.

In some sense, you can say that not having stories to tell is a disadvantage when you are trying to convince someone to do or buy something, whether it is a lay investor or even an investment professional (it is just not as satisfying without stories, isn't it?).

In fact, when I used to be on the sell side – that is, when our primary business was being a broker to fund houses, both international and Indian – the question I would get most often when I recommended a stock was, 'What is the story?'

So much so that in a kind of joke, we began to start our research reports with page of what we called 'The Story'.

It was a take-off on the constant demand from the banks and fund houses for the stories behind our picks.

While humans love stories, the market doesn't care

Of course, this was only an ironic take. And, over time, I began to understand the phenomenon more and realized that with tools to deal with big data groups it was only a matter of time before the story was confined to the rubbish heap of history.

There was no doubt then that if you were trying to outperform the market, going by data instead of stories was what would give you results. Hence our entire investment process was geared to take advantage of this truth.

In theory, we all want to say that we make investment decisions based on data, but if I tell you that we bought a particular stock because the return ratios were expanding, growth across quarters was consistent, asset utilization was the best in class, it had no apparent corporate governance issues and it was in the top 10 per cent in most of the factors that we like to look at, it does not sound as exciting as stories of a superb brand, visionary management or huge orders in the future, etc.

As human beings, we do not want dry data and statistics; we want juicy stories, and that is exactly how the market entraps us.

Because the market is not a human being and does not mind breaking our heart over a carefully crafted story.

Steer clear of conviction and emotion when it comes to your securities

The data-based approach has served us very well, and the results are there for all to see in both First Global's PMS product as well as its Global funds and portfolios, especially on a risk-adjusted return basis.

By not attaching conviction, and therefore emotion, to our ideas, we have been able to move in and out of sectors and stocks far ahead of the market.

By way of a few illustrations, we went overweight in industrials and capital goods based on our systems way back in October 2021 when most fund managers began to understand and tell that story only in 2023 when the stocks had already doubled and tripled!

While that sector had been an underdog for twelve years, from 2009 to 2021, the fundamentals were changing because of the order book and sales pick-up. Plus, the many lean years had resulted in cost efficiencies, so once the business came in, the margins began to expand.

For many fund managers it remained in the dog category for many more quarters and their investors missed the major move in the stocks. **Because, for human beings it is very hard to change the stories they have formed in their heads.**

At a time when everyone started to pile into the sector, we began to evaluate whether that story had run its course.

Similarly, when FMCG was the story being sold throughout 2020, we were among the few fund houses to say that it did not make sense to us, based on data. However, even back then, those who loved the sector, barely ever spoke about ITC or Gillette India as FMCG companies because those particular stocks were not doing well at the time.

On the other hand, almost the first FMCG stock recommended by our systems was ITC, which we bought in early 2021 and which became a huge winner for us because we had no bias against it. Ironically, a number of fund managers who were proponents of the FMCG story never bought ITC, at least in the initial period of its upward move, because they were wedded to their old stories.

On the other hand while stocks like Tata Elxsi and ITC were among our top performing stocks in the PMS for several years we did not kid ourselves that these were high conviction bets to be held for ever.

They were held till our systems liked them and we exited thereafter.

A system is designed to get rid of human bias, as well as noise, which is introduced any time human beings make judgements and decisions. A dozen fund managers given the same information about the same company will have different opinions. That is noise. A single person will look at the data differently depending on whether they had a fight in the traffic in the morning. That is also noise.

As Daniel Kahnemann, whom I consider my Guru, says, *'A well-designed system will always outperform a human expert.'*

To give another example, we evaluate all our holdings on a zero base every quarter, essentially answering the question as to where we would be invested if we had cash today. This is to get rid of endowment bias, which makes us value what we hold higher than we should. The hold rating exists in the world only because of Endowment bias as logically you should not hold anything that you will not buy today at today's price.

The story misleads not just the listener

And you know the most fascinating thing about storification?

It is that in the end it misleads not just the listener but also the storyteller!

The narrators repeat the story so many times that they also begin to believe it. And the best among us fall prey to this.

That is reason enough to steer clear of building high conviction in your holdings, which is nothing other than building stories about them in your head.

As for high conviction, what better example than that ***the companies profiled in the books In Search of Excellence and Good to Great were UNDERPERFORMERS compared with the S&P 500 basket in the decade after the publication of the books. They were laggards not just in terms of stock price performance, but also sales and profit growth.***

Even when we look at the list of the top contributors to our PMS performance in previous years, we find that we don't hold many of these stocks any more – for example, the chemical companies that did so well for us in 2021-22 disappeared from the portfolios thereafter.

If we had gotten married to these stocks by telling ourselves great stories about them, we wouldn't have been able to get out in time!

Stories can always be found to justify why the performance of a stock or even a company was great at some point in time, but most of them are merely used to justify what is happening in the present.

How many people even remember that Cisco was the once highest market-cap company in the whole world and was the most coveted investment ...and then crashed by 86%? Or the dream run of ABB? Not to mention Enron?

There are plenty of such examples in the Indian market too. ***The initial Sensex list had textiles, shipping, Premier Automobiles, Hindustan Motors and groups like the Mafatlals, JK, Thapars, etcetera, dominating – all of whom have been consigned to history now.***

At one point, the major indexes had zero weightage for banks and financials. As I write today, they have the highest weightage in the indexes. There were also seven or eight PSUs in the Sensex at one time. And then everyone forgot about them for almost a couple of decades.

Fashions, performance, themes, narratives, all come and go.

And it is also another human bias to forget what we were actually thinking and saying once the time and facts have changed. Hindsight bias makes us believe that we always knew what was going to happen.

That's the data!

The rest, you've guessed it, stories.

In summary

- It is considered the right thing for you to have high conviction in your investments. But my whole investment process is anti-storification and anti-high conviction – deliberately, consciously and systematically so.
- All studies and data have shown that while human beings love stories, storification is one of the systematic biases that bring down investment returns.

- By not attaching conviction, i.e., emotion to its investments, First Global has been able to move in and out of sectors and stocks ahead of the market.
- Even well-known companies, brands and stocks fall out of favour.
- Data-driven investing brings far better results than those dependent on stories and emotion, which is what conviction is about.

(Devina Mehra is Founder, Chairperson and Managing Director of First Global, an Indian and global asset management company, and author of the National best seller 'Money, Myths and Mantras: The Ultimate Investment Guide'.

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