…of oaks and reeds

phreak’s tao

me

- I write code for myself, architect software systems for others, read a lot of fiction and non-fiction, write when I need to understand something or express opinion/ideas, love to learn completely new things every 2-3 years(Investing being the latest fancy), play guitar and travel a fair bit
- In the market post demonetisation, in an attempt to protect wealth from falling interest rates and inflation
- Have a strong problem-solving and DIY mind-set
- Identify myself as a trader than an Investor, as of today
- Market has helped me transition from being deterministic and rigid to probabilistic and fluid (oaks vs reeds), in all walks of life. This in itself is a phenomenal return on equity (my time) for me, than the computed ones

my blunders

- Tips
- Junk stocks
- Buying too late (Late cycle commodities)
- Selling too early (Secular growth stories)
- Holding and averaging losers, selling winners instead of averaging up
- Misunderstanding timeframes
- Letting emotions, be it fear, greed or hubris run amok
- Poor position-sizing
- Inability to completely avoid the brothers and sisters of these mistakes that show up with some variations

beliefs/observations

- In the sufficiently long-term, **everything reverts to the mean**
- Same method will not work for all markets
- What must break should be allowed to break quickly
- What the business does, what fellow shareholders do and more importantly what you do, all feed off each other to affect returns (on either side)
- Both broad-focus and narrow-focus are equally important to scan and be open to ideas and to also have the ability to go deep and wide to **build conviction** as well as to **shoot-down favourite thesis**
- Everyone having contradicting opinions could be right and wrong in different timeframes
- Can you live with the minutes, hours, days, weeks and months of being potentially wrong, even if you are eventually right?
- Liquidity (cash & float) and consensus, act like a DDoS (Distributed denial-of-service) attack and it cuts both ways (breakouts & breakdowns)
- Human spirit is phenomenal when incentivized to survive/innovate. In the long run, capitalism, free markets and trade will tremendously improve life. Short-term busts due to risk, greed & fear are unavoidable as same qualities that lead booms, lead to busts.

beliefs/observations

- What’s not verifiable isn’t probably true. Trust empirical evidence
- What’s true is merely awaiting falsification (à la *Karl Popper*)
- Scepticism is the religion to follow, when dealing with uncertainties
- When we are unsure, we trust and when uncertain, we herd
- Decisions under duress are very harmful
- **Knowing and doing are very different things** and the yawning chasm in-between could take a lifetime to bridge. (*Acta non verba – Deeds, not words)*
- We must be greedy when others are fearful – Does **knowing** this translate to **doing**, seamlessly, when fear and panic engulfs the street?
- If money is **a proof of work performed**, with the current levels of leverage globally with ZIRP/NIRP, money is becoming more **a unit of work to be performed**. Though both have indistinguishable purchasing power, ZIRP/NIRP money is chasing much longer-term assets, owing to the repayment timelines
- With preference for renting vs owning and the monthly cash flow used towards experiences (euphemism for neophilia), big ticket loans might be on the way down while small ticket loans (travel – flights & hotels, gadgets, appliances) might be on the way up. Serfdom continues in a different form, where land is replaced by selfies in exotic lands, check-ins in 5* Resorts, Michelin star restaurants and iPhones (Status signaling, digitally).

consensus

Consensus is something which is there, until its not - like the Cheshire cat’s grin in *Alice in Wonderland,* it lingers a bit after cat has disappeared. Consensus and herding goes hand in hand - all it takes is someone yelling "bomb" in an airplane for chaos to unfurl

"'Well! I've often seen a cat without a grin,' thought Alice 'but a grin without a cat! It's the most curious thing I ever saw in my life!'"

behaviour

- Experiencing vs Remembering self – Give voice to the speechless man (Eg. Jot down on a day-to-day basis what it felt like to hold an illiquid stock). Outcome makes great stories but the voiceless man within knew the real story which is forgotten post outcome.
- Speak freely about failures but never about success to avoid hubris
- Ensure public discussions don't lead to commitment bias – there is no need to defend an idea. Its not your child.
- Wander outside your circle of competence, with a firm tether to return
- Contrarian for the sake of it, doesn't quite cut the mustard
- *Hormesis* - inject bad stocks into the portfolio to observe personal behavior - vicarious learning can only go so far. Another step closer to bridging the gap between knowing and doing. Like controlled forest fires.
- Focus on process and maintain an equanimity about the outcome and don't judge a decision based on outcome (hindsight bias) *(Luck is what happens when preparation meets opportunity - Seneca)*
- When in trouble, remember the pale blue dot. *(We suffer more in imagination than in reality - Seneca)*
- Should the "I" of the present have more say than the "I" of the past/future?

why trade?

- To understand nuances of the market from the viewpoint of a trader – sort of to **learn first principles** of what moves the markets and who the stakeholders are
- Generate free cash flow, when the going is good
- Trading is asset-light with high capital turns, Investing is WC intensive (Portfolio is Inventory). Trading is WC intensive, if you are an Operator. ☺
- To hone the ability to deal with cognitive dissonance
- To gain the mental agility to be brutally decisive
- To learn position-sizing intuitively and empirically (So as to bake Kelly's formula into the brain to work reliably)
- Long-term is made up of several short-terms
- With low risk appetite, I tend to seek high risk activities (More on this later)
- *"The cleverest of all, in my opinion, is the man who calls himself a fool at least once a month." – Dostoyevsky* (Trading provides adequate humbling ☺)

problems with trading

- Breeds terrible short-term mind-set
- What works over several short-terms may not scale well long-term
- More decisions means that odds of mean-reversion are higher
- Odds of success with higher capital base is poor
- Near-impossible to run money for others, due to blended risk appetite
- Returns adjusted for stress, at times mediocre
- Unless automated, ability to compound is difficult
- Unglamorous. Instead of a lovely, coherently worded impressive newsletter that portrays your values, you have a bizarre trading journal in latin that makes you oft times wonder – 'What do I mean here?'

allocation

- Love the barbell strategy at a macro level. Having 80% of capital in FDs still has given me a license to take high-risk trades with the remaining 20%
- The reasonable returns on the 20% of capital have come at a higher risk, thereby making this strategy untenable for the remaining 80% of Capital
- Idea is to re-allocate 80% in FDs with a 30-30-20 split from low-risk to medium-risk assets, over the next 3 years
- 30% would continue to remain in FDs, 30% in blue chips (very low churn coffee-can) when there is valuation comfort in the businesses I like and 20% towards enterprising businesses. The barbell re-distribution would curtail current high-risk in trading folio, reduce churn and moderate returns to predictable levels.
- Micro-level allocation driven by odds/edge (Kelly's formula)
- Allocation scaled up/down over time in 2-5 transactions, spread based on beta
- **Concentrated vs Diversified** - Holding too many stocks lulls you into inaction as more decisions have to be taken if you decide to reduce size of portfolio - for eg. which stock and how much. Less stocks make it easy as long as the correlation is minimum. For eg. it makes no sense to hold Nocil, Escorts, MRF, VST Tillers all in the same portfolio - They are all highly correlated to the economic cycle.
- Correlation is a powerful concept that's not paid its due, like mean reversion. Correlation by sector, economic cycle, risk-off/on, market cap, region etc. must all be considered

business checklist – soft criteria

- Smaller/invisible products with sophistication
- Small ticket size, repeat customers
- Products with longevity(lindy effect) & simplicity
- Large under-penetrated market with long runway for growth
- Brands/patents/distribution/low-cost – at least some moat
- A brand that can't command premium is no brand at all
- Proven management
- High promoter holding showing skin in the game
- Avoid businesses that thrive on subsidies and govt. policies
- Low risk of disruption

business checklist – hard criteria

- Low or zero debt (D/E < 0.3) with great interest coverage ratio
- Great return ratios (RoCE > 20)
- Good and stable margin profile. Increasing trajectory a plus
- Generates FCF consistently
- Can re-invest capital at high rates of return over long periods
- Stable/Improving Working Capital cycles
- Less/No dilution
- Valuation at least fair or under-valued compared to historical multiples/comparable peers/sector. DCF only to visualise, not to compute.

businesses I like

bluechip

- Titan
- Havells
- HDFCAMC
- Lombard
- Britannia
- Nestle
- Pidilite
- Asian Paints
- Dmart
- Reliance

enterprising

- Naukri
- Bata
- Page
- Eicher
- Valiant
- Fairchem
- Siemens
- DCB Bank
- PSP Projects
- NGL
- Ujjivan
- Bandhan
- Dr Lal Pathlabs
- UBL
- TVS Motors
- Honeywell
- Syngene
- Aarti Inds

qualms

- Will I be able to box my behaviour based on portfolios? (Eg. Not carrying high-risk trades into enterprising portfolio and not letting coffee-can mentality affect trading)
- Obvious solution appears to be to trade holdings by increasing/decreasing allocations based on under/over-valuation or technicals. This reduces endowment bias while selling and the utility of already knowing the business would help as well. But will this only bring more trouble with the way brain deals with anchoring?
- If my equity is my brain's compute time, am I going to fetch adequate returns on equity with the above?
- Should I be trading at all? Can a comedian move onto character roles?

…of oaks and reeds

better to yield when it is folly to resist,

than to resist stubbornly and be destroyed

from Aesop's fables, greek tales, tao te ching, Talmud to Tagore – this parable has undergone transformations from oak to olive trees, willows and firs but the underlying message of fragility that comes from rigidity, still stands relevant.

books/influences

- Nassim Nicholas Taleb (Fooled by Randomness & other works)
- Daniel Kahneman (Thinking fast & Slow)
- Munger/Buffett – Poor Charlie's Almanac & Buffett Letters
- Seneca and Stoicism, Tao Te Ching, Buddhist beliefs
- Pat Dorsey, Phil Fisher, Peter Lynch & Howard Marks books
- Game Theory (The Art of Strategy)
- Gödel, Escher, Bach – Douglas Hofstadter
- Jesse Livermore – Reminiscences of a Stock Operator
- George Soros – Alchemy of Finance
- Matt Ridley - The Rational Optimist
- Jared Diamond - Guns, Germs & Steel
- Richard Dawkins - The Selfish Gene
- Marcel Proust, Haruki Murakami, Lewis Carroll & Fyodor Dostoevsky's works