



# 4 C's of investment



Cloning



Checklist



Capital Allocation



Checkout

Ashish Kila

Perfect Research

## ❖ Presented by:



## Mr. Ashish Kila

- ▶ CA
- ▶ MBA from MDI, Gurgaon
- ▶ Worked with:
  - Goldman Sachs
  - Religare Securities
  - Morgan Stanley
- ▶ Currently working as
  - Director, Perfect Group
  - CIO, Perfect Research





## ❖ Acknowledgements:

- ▶ Our Chairman - Mr. R.A. Kila

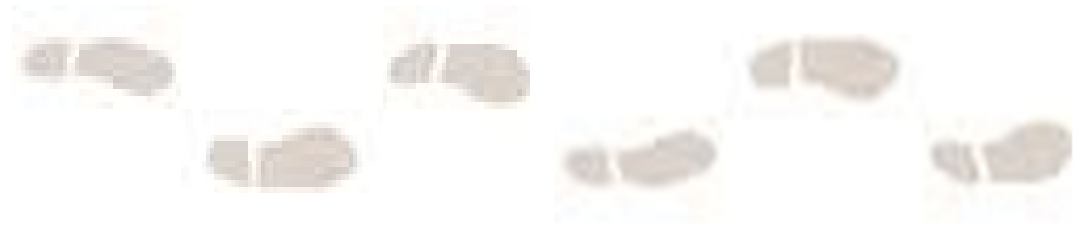


- ▶ Perfect Research Team: <http://www.perfectresearch.blogspot.in/p/about-us.html>



# Coattailing/Cloning:

Study the stocks that smart investors are buying and buy the ones you understand...





## ❖ Mohnish Pabrai on Coattailing:

### Copy and Compound

- ▶ In an egocentric world where copying is seen as a shameful admission of failure, Mohnish Pabrai makes an indelible mark with a Copycat strategy.
- ▶ One can find a great investment opportunity by copying successful value investors' methods and picks as he mentioned "Be a cloner, but clone the best".
- ▶ When you choose whom to clone, you need to ensure that your hero himself is placing enough faith in the stock. Check his percentage allocation and bet where he has allocated the larger amount of his portfolio.

Source: <http://blogs.isb.edu/cfi/2013/10/31/mohnish-pabrai-on-cloning-as-a-strategy/>  
[http://www.outlookbusiness.com/article\\_v3.aspx?artid=285693](http://www.outlookbusiness.com/article_v3.aspx?artid=285693)



## ❖ Continued...

- ▶ Mr. Pabrai chose to clone Warren Buffett because for Mohnish Pabrai, the truest Eklavya of the investment world, the guru is none other than Warren Buffett.
- ▶ Look at what great investors are buying but take the decision only after you understand it and which passes your own checklist.
- ▶ Besides Buffett, the investors that Mohnish closely follows include Baupost, Longleaf Partners, Greenlight Capital, Pershing Square, Third Avenue and Fairfax Holdings.
- ▶ Pabrai's copy-the-best strategy is not restricted to stock picking; he has also copied Buffett in philanthropy.



## ❖ Charlie Munger on Coattailing:

- ▶ Mohnish Pabrai shared his experience about what he learned during his lunches with Charlie Munger and Warren Buffett in an interview with The Motley Fool.
  
- ▶ Pabrai talked about how Munger revealed 3 things investors can do to be successful:
  1. ***Carefully watch what other investors are doing***
  2. "Look at the cannibals" - look at the businesses that are buying back huge amount of their own stocks
  3. Carefully study spin-offs



Source: <http://www.marketfolly.com/2013/01/charlie-munger-warren-buffetts-secrets.html#ixzz2pu19Pah5>



## ❖ SEC Form 13-F and Cloning:

- ▶ In US, Form 13-F is a quarterly filing disclosure required of institutional investment managers with over \$100 million in qualifying assets.
- ▶ It makes easy to look into great investors' minds in US.
- ▶ What about India where we don't have 13-F ?

**Here, we have “ Jugaad ” which works everywhere no matter what the situation is.**







# ❖ SEC Form 13-F alternative in India:

- ▶ Track Bulk and Block deals on **NSE/BSE**.

**BSE**  
EXPERIENCE THE NEW

S&P **BSE**  
SENSEX

About BSE ▼ **Markets ▲** Public Issues / OFS ▼ Corporates ▼ Members ▼

Equity ▼ Derivatives ▼ Indices ▼ Currency Derivatives ▼ IRD ▼ Debt ▼ S

**Live Reports**  
Pre Open Session  
    ❖ Equity  
    ❖ Special / IPO Relistings  
Equity Market Watch  
Illiquid Scrips Market Watch  
Gainers

**End of Day Reports**  
Trading Highlights  
Companies by Market Capitalization  
Investor Categorywise Turnover  
BSE Gross Deliverables  
**Bulk Deals**  
**Block Deals**

Source: [http://www.bseindia.com/#markets\\_eq](http://www.bseindia.com/#markets_eq)



## ❖ SEC Form 13-F alternative in India:

- ▶ One can search with individual name or fund on Moneycontrol.com website or on some paid software like ( Ace equity, Capital line, Prowess etc. )
- ▶ Check holding on **Moneycontrol.com**:

**What stocks do they hold?**

Public  Promoter

**Shares held by Morgan Stanley**

Company	% Holding	Rs Crore
Indiabulls Hsg	5.09	647
Lloyd Electric	4.94	19
Venus Remedies	4.89	16
SKS Microfin	4.11	123
Jubilant Food	4.09	349

[more >>](#)

Rakesh Jhunjhunwala | JP Morgan | Citi | Goldman Sachs | HSBC | Deutsche | Templeton | Aberdeen

Source: <http://www.moneycontrol.com/bse/shareholding>



## ❖ SEC Form 13-F alternative in India:

- ▶ One can create **Google alert** to track particular investment gurus or investment fund. Automatic mail will be received as per the setting.

Google

### Alerts

Search query:

Result type:

Language:

Region:

How often:

How many:

Deliver to:

There are no recent results for your search query. Below is a sample of the type of results you will get.

**News** 2 new results for **westbridge**

**Westbridge Ventures sells 11.73 lakh shares of SKS Micro**  
Moneycontrol.com

**Westbridge Ventures sells 11.73 lakh shares of SKS Micro.** On June 26, 2014  
**Westbridge Ventures II LLC sold 11,73,492 shares of SKS Microfinance ...**

**PE firm Westbridge reduces its stake in SKS Microfinance**  
Livemint

Hyderabad: Private equity (PE) firm **WestBridge Ventures II LLC** on Thursday sold 1.5 million shares or around 1.2% stake in SKS Microfinance Ltd, ...



# ❖ SEC Form 13-F alternative in India:

## ▶ ACE Equity Software:

The screenshot shows the ACE Equity v2 - 5.7.0 software interface. The 'Expression builder' tab is active, showing a tree view of fields under 'Equity' with 'Holding More than 1%' selected. The right panel contains various configuration options like 'Show actual values for formulae', 'Annualised', and 'Consolidated priority'. Below the interface is a table with 7 rows of data.

FieldOrder	Table Name	Field Name	Select Period	Criteria	Display	Sort
0	SHPD_1	SHPD_Date End	L		<input checked="" type="checkbox"/>	
1	SHPD_2	SHPD_Date End1	L-1		<input checked="" type="checkbox"/>	
2	SHPD_1	SHPD_Holder's Name	L		<input checked="" type="checkbox"/>	
3	SHPD_2	SHPD_Holder's Name1	L-1		<input checked="" type="checkbox"/>	
4	SHPD_1	SHPD_No of Shares	L		<input checked="" type="checkbox"/>	
5	SHPD_2	SHPD_No of Shares1	L-1		<input checked="" type="checkbox"/>	
6	SHPD_1	SHPD_Percentage	L		<input checked="" type="checkbox"/>	
7	SHPD_2	SHPD_Percentage1	L-1		<input checked="" type="checkbox"/>	

**Like %IDFC%**

- ▶ One can follow these blogs for investment ideas:



- ▶ List of some of the blogs we follow in alphabetical order.

Name	Blogs
Abhinav Mansinghka and Niren Parekh	<a href="http://manufacturedluck.blogspot.in/">http://manufacturedluck.blogspot.in/</a>
Abhishek Basumallick	<a href="http://valueinvstr.blogspot.in/">http://valueinvstr.blogspot.in/</a>
Amit Arora	<a href="http://multibaggersindia.blogspot.com/">http://multibaggersindia.blogspot.com/</a>
Ankur Jain	<a href="http://calculatedwagers.blogspot.in/">http://calculatedwagers.blogspot.in/</a>
Ashish Kila	<a href="http://perfectresearch.blogspot.in/">http://perfectresearch.blogspot.in/</a>
Ashok	<a href="http://indinvestor.wordpress.com">http://indinvestor.wordpress.com</a>
Ayush Mittal	<a href="http://dalal-street.in/tag/value-pick/">http://dalal-street.in/tag/value-pick/</a>
Bosco	<a href="http://zeenut.blogspot.in/">http://zeenut.blogspot.in/</a>



Name	Blogs
Chinmay	<a href="http://www.indiavalueinvest.in/">http://www.indiavalueinvest.in/</a>
Devesh	<a href="http://deveshkayal.wordpress.com/">http://deveshkayal.wordpress.com/</a>
Dhwanil Desai	<a href="http://valueinvestinginpractice.blogspot.in/">http://valueinvestinginpractice.blogspot.in/</a>
Gaurav	<a href="http://www.gauravblog.com/">http://www.gauravblog.com/</a>
George	<a href="http://www.rationalportfolio.com/">http://www.rationalportfolio.com/</a>
Hitesh	<a href="http://hitstocks.blogspot.in/">http://hitstocks.blogspot.in/</a>
Investingkitten	<a href="http://investingkitten.wordpress.com/">http://investingkitten.wordpress.com/</a>
Invictus	<a href="http://in-victus.blogspot.in/">http://in-victus.blogspot.in/</a>
Ishaan Gupta	<a href="http://www.igvalue.com">http://www.igvalue.com</a>
Jagpreet Bhatia	<a href="http://valuearchitects.blogspot.in/">http://valuearchitects.blogspot.in/</a>
Jana Vembunarayanan	<a href="http://janav.wordpress.com/about/">http://janav.wordpress.com/about/</a>
Jatin Khemani	<a href="http://jatinkhemani.wordpress.com">http://jatinkhemani.wordpress.com</a>
Kiran Dhanwada	<a href="http://kiraninvestsandlearns.wordpress.com/">http://kiraninvestsandlearns.wordpress.com/</a>
Jayendra Kulkarni	<a href="http://libraryequity.blogspot.in/">http://libraryequity.blogspot.in/</a>
Neeraj Marathe	<a href="http://neerajmarathe.blogspot.in/">http://neerajmarathe.blogspot.in/</a>
Ninad Kunder	<a href="http://investingvalues.blogspot.in">http://investingvalues.blogspot.in</a>



Name	Blogs
Niteen S Dharmawat	<a href="http://dharmawat.blogspot.in/">http://dharmawat.blogspot.in/</a>
PerknLife	<a href="http://perknlife.blogspot.in/">http://perknlife.blogspot.in/</a>
Prabhakar Kudva	<a href="http://investment-in-sight.blogspot.in/">http://investment-in-sight.blogspot.in/</a>
Pratik Gandhi	<a href="http://pratikgandhi2531.blogspot.in/">http://pratikgandhi2531.blogspot.in/</a>
Prof. Sanjay Bakshi	<a href="http://www.sanjaybakshi.net/">http://www.sanjaybakshi.net/</a>
Purvi Shah	<a href="http://purvismultibaggerstockideas.blogspot.in/">http://purvismultibaggerstockideas.blogspot.in/</a>
Rudra Chowdhury	<a href="http://prdntinvestor.blogspot.in/">http://prdntinvestor.blogspot.in/</a>
Safir	<a href="http://safirpicks.wordpress.com">http://safirpicks.wordpress.com</a>
Subash	<a href="http://art-of-mental-modelling.blogspot.in/">http://art-of-mental-modelling.blogspot.in/</a>
Value pick from Indian Stock markets	<a href="http://value-picks.blogspot.in/">http://value-picks.blogspot.in/</a>
Vishal Khandelwal	<a href="http://www.safalniveshak.com/">http://www.safalniveshak.com/</a>
Zorba Yogi	<a href="http://multibaggeryogi.blogspot.in/">http://multibaggeryogi.blogspot.in/</a>

# ❖ One can also follow these Forums and Subscriptions:

## ▶ Forums:

Name	Forums
ValuePickr	<a href="http://www.valuepickr.com/">http://www.valuepickr.com/</a>
The Equity Desk	<a href="http://www.theequitydesk.com/">http://www.theequitydesk.com/</a>

## ▶ Subscriptions : ( in no particular order)

Name	Subscriptions
Basant Maheshwari	<a href="http://www.theequitydesk.com/basantscorner/ask-basant.asp">http://www.theequitydesk.com/basantscorner/ask-basant.asp</a>
Rohit Chauhan	<a href="mailto:rohit_chauhan@rcfunds.com">rohit_chauhan@rcfunds.com</a>
Rahul Goel	<a href="http://www.equitymaster.com/">http://www.equitymaster.com/</a>
Ekansh Mittal	<a href="http://www.katalystwealth.com/">http://www.katalystwealth.com/</a>
Manish Dhawan	<a href="http://www.mysticwealth.in/">http://www.mysticwealth.in/</a>
Punit Jain	<a href="http://jainmatrix.com/">http://jainmatrix.com/</a>

Although we are not endorsing any subscriptions





- ▶ One can also follow these smart investor/funds
- ▶ List of some of the smart investors in alphabetical order:-

Name of the Smart Investors
Abhishek Dalmia
Anil Kumar Goel
Anuj Anantrai Sheth
Ashish Dhawan
Ashish kacholia
Ashwin Kedia
chetan parikh
Dilipkumar Lakhi
Dolly Khanna
Girish Gulati
Lashit Sanghavi
Parag Parikh
Prof. Sanjay Bakshi
Prof. Shivanand Mankekar
Radha Krishan Damani
Rakesh Jhunjhunwala
Ramesh Damani
Vijay Kishanlal Kedia



► List of funds in alphabetical order:-

Name of the Funds
AADI Financial Advisors LLP
Aberdeen Asset Management
Abu Dhabi Investment Authority
ACACIA Group
Aditya Birla Private Equity
Albula Investment Fund
Alchemy India Long Term Fund
Amansa Capital
American Funds Insurance
AMERICAN FUNDS INSURANCE SERIES
Arisaig Partners Asia Pte
Arohi Asset Management
Ask Securities
Avalokiteshvar Valinv Ltd
Azim Hasham Premji

Name of the Funds
Baring India Private Equity
BEAVER INVESTMENT HOLDINGS
Bessemer Venture Partners
Blackstone GPV Capital Partners
Bonanza Portfolio Ltd
Catamaran Ventures
Citigroup Global Markets Mauritius Pvt. Ltd
Clareville Capital
Clearwater Capital
CLSA (Mauritius) Ltd
College Retirement Equities Fund
Creador
Credit Suisse
Edelweiss Financial Services
Elm Park Fund Limited
Enam Capital



▶ Continued:-

Name of the Funds
Fidelity
Genesis
GMO Templeton
Goldman Sachs India Equity Fund
Government of Singapore
Government Pension Fund Global
Hdfc Fund
India Capital Fund Ltd
India deep fund
IRONWOOD INVESTMENT HOLDINGS
Janus Capital
Jwalamukhi Investment Holdings
Kotak Mahindra
Macquarie Bank
Malabar Investments
Mentor Capital
Morgan Stanley Asia (Singapore) Pte

Name of the Funds
Motilal Oswal
Nalanda capital
ONTARIO TEACHERS' PENSION PLAN BOARD
Oppenheimer Capital
PineBridge Investments
Platinum Investment Management
Prime Securities/Prime broking
Raiffeisen Capital Management
SMALLCAP WORLD FUND, INC
surefin financial consultants
T Rowe Price
Third Avenue
TOYO DENKI SEIZO KK
Treeline Asia Master Fund
Vanguard
Wasatch Funds
Westbridge Capital

## ❖ Coattailing – Strategies:

- ▶ There are three kinds of coattailing strategies:

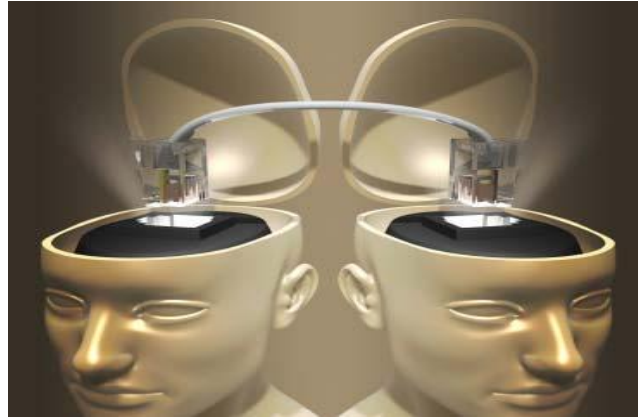
1) Select four or five investors and copy them exactly.

2) Select four or five investors and pick the best/top of their ideas.

3) Select four or five investors and pick stocks which you can understand and which passes your own checklist.



## ❖ Copying the Guru completely:



- ▶ If one bought what Buffett had bought after it became publicly known, and sold it after it was known publicly that Buffett had sold it,
- ▶ And if it is followed for every stock that Warren Buffett had bought and sold for 30 years, one would have beaten the index by 11.5% a year.

*Cloning strategy looks too easy, which almost anyone can implement but not many do.*

Source: <http://blogs.isb.edu/cfi/2013/10/31/mohnish-pabrai-on-cloning-as-a-strategy/>



## ❖ How to pick best of their ideas:

### ▶ Top Holding of the investors:-

Instead of following all the holdings of the investor, one can follow largest picks of his fund .



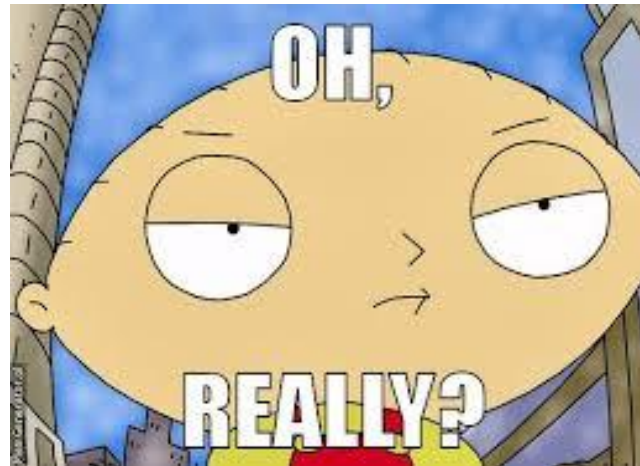


## ❖ Cloning as % of company size allocation :

- ▶ Suppose ,we follow IDFC Premier Equity fund.
- ▶ Its investment in Page Industries as a % of company size is only 3.73% against 4.29% of V-Mart Retail Ltd.
- ▶ Being a cloner, we might tend to favour V-Mart Retail rather than Page Industries.



Source: <http://www.morningstar.in/mutualfunds/f0gbr06r9h/idfc-premier-equity-fund-plan-a-growth/detailed-portfolio.aspx>



## Just Jockeying

It's so early to reach at conclusion. Let's dig a little more ...





## ❖ Caution Note :

IDFC Premier Equity Fund						
S.No.	Name	Sector	Wt. as a % of Comapany Size	Wt. as a % of Portfolio Size	Market Value (mn.)	No. of shares
1	Page Industries	Textile products	3.73	6.00	2647	409,500
2	V-Mart Retail Ltd	Retailing	4.29	0.54	238	763,723

- ▶ However, if we analyse the stock based on the % of Portfolio size. we see that fund has allocated 6% of portfolio in Page Industries against merely 0.54% in V-Mart Retail Ltd. It shows fund has more conviction about Page Industries than V-Mart Retail Ltd.
- ▶ But If we would have analysed the stock based on the % of company size, we end up picking up V-Mart Retail Ltd. against Page Industries.
- ▶ Hence, investment decision should be based on % of portfolio size not based on % of company size.



# ❖ Problems in determining % bet size of individual investors

- ▶ Unlike funds, the entire networth of the large smart investors which we are cloning is not readily available, so calculation of % bet size is tough
- ▶ One way to get around is
  - Measure the bet size against other bets taken by the same investor to assess the relative weight of the bet



## ❖ Cloning as per Trends in Portfolio

- ▶ Amount allocated by IDFC Fund has increased by 36.71% in case of BATA India Ltd but only 15.59% in case of Jyothy Laboratories

Bata India Ltd	
Quarter Ended	Amount (Cr.)
Mar-14	184
Dec-13	171
Sep-13	138
Jun-13	135

Jyothy Laboratories	
Quarter Ended	Amount (Cr.)
Mar-14	45.76
Dec-13	41.81
Sep-13	36.59
Jun-13	39.59

- ▶ Being a cloner, we might tend to prefer Bata over Jyothy.....



## ❖ Caution Note :

- ▶ Increase in allocation is due to PRICE increase while number of shares remaining same.

Bata India Ltd		
Quarter	No. of shares	Price on BSE
Mar-14	1,615,000	1,138.90
Dec-13	1,615,000	1,056.55
Sep-13	1,615,000	853.3
Jun-13	1,615,000	833.1

Jyothy Laboratories		
Quarter	No. of shares	Price on BSE
Mar-14	2,200,000	208
Dec-13	2,200,000	190.05
Sep-13	2,200,000	166.3
Jun-13	2,200,000	179.95

## ❖ Cloning as per current allocation:

IDFC Premier Equity Fund	
<b>PTC India Ltd</b>	
Quarter Ended	201403
% of Shares	4.05
No. of Shares	120,00,000

IDFC Premier Equity Fund	
<b>Trent Ltd</b>	
Quarter Ended	201403
% of Shares	1.47
No. of Shares	4,89,782

Fund has significant investment in both the companies. **Should I clone both?**





## ❖ Caution Note :



IDFC Premier Equity Fund						
<b>PTC India Ltd</b>						
Quarter Ended	201403	201312	201309	201306	201303	201212
% of Shares	4.05	4.05	3.72	3.72	3.72	2.58
No. of Shares	120,00,000	120,00,000	110,00,000	110,00,000	110,00,000	76,37,000

- ▶ Here, we can see that fund is increasing the allocation in PTC India Ltd over period of time. It shows fund's conviction about stock is increasing.



IDFC Premier Equity Fund						
<b>Trent Ltd</b>						
Quarter Ended	201403	201312	201309	201306	201303	201212
% of Shares	1.47	1.98	1.98	1.98	1.98	1.98
No. of Shares	4,89,782	6,56,606	6,56,606	6,56,606	6,56,606	6,56,606

- ▶ Here, we can see that fund is decreasing the allocation in Trent Ltd over period of time. It shows fund's conviction about stock is decreasing.

*As a cloner, I will choose PTC India Ltd over Trent Ltd.*

In recent quarter, IDFC is no more invested more than 1% in Trent Ltd



## ❖ Popularity :

We try to look for stock in which large number of smart investors have invested because it gives higher conviction about that particular stock.

AIA Engineering Ltd.	
Name	% of Shares as on 31 March 2014
Burgundy Asset Management Ltd A/C Burgundy Emerging Markets Fund	1.13
Genesis Indian Investment Company Ltd	4.04
HDFC Trustee Company Ltd HDFC Prud Fund	2.24
Mathews India Fund	2.45
Nalanda India Equity Fund Ltd	8.4
Pinebridge Investments Asia Ltd Pinebridge Investments GF Mauritius Ltd	1.01
Small Cap World Fund Inc	4.98
Tata AIA Life Insurance Co Ltd Whole Life MID Cap Equity Fund ULIP 009	1.14
Jwalamukhi Investment Holdings*	1.70

\* Recent bulk buying

## ❖ Price Analysis :

We analyze the price of stock purchased by fund/investor to check whether the price of stock increased since the fund/investor has bought it.

**Strategy :** We try to find out stocks which have not moved.

Example: Godfrey Phillips India







# Avoid Price Anchoring...

- ▶ In addition to price analysis, one can also follow the valuation multiples for the company. Even when stock price has run up over a period of time, sometimes stock is available at similar valuation multiples as when the fund/investor had bought it.



## ❖ Caution Note:

- ▶ No investor has 100 % strike rate, not even Warren Buffett (Eg- Dexter shoes)
- ▶ In cloning strategy, investors try to find out stocks which have not moved after a smart investor/fund has entered. They do so because they don't want to over pay as compared to smart investor/fund.
- ▶ Here in this case one might end up picking all underperformers of his portfolio.



## ❖ Some thoughts

- ▶ Focus on Cloning the Thought Process and not just ideas
  - ▶ It is good to clone ideas but even better if through vicarious learnings (other people's experiences) you can avoid the mistakes they have learnt through experience
- ▶ Role of Networking
  - ▶ It is essential in my opinion to create a good set of friends and mentors
- ▶ Don't clone blindly instead use it as a screening tool to shortlist companies to study
- ▶ Cloning will tend to miss out ideas from micro/small cap space
  - ▶ Due to liquidity considerations, large investors are normally able to buy in only mid/large cap names



# Checklist

How to avoid errors and learn from mistakes...!!!





## ❖ Secret of Mohnish Pabrai's Higher Returns

- ▶ Invested 200 million in more than 30 different stocks in 2008
- ▶ Exited most of them in 3-5 yrs with 500 million
- ▶ Loss on only 2 investments out of 30
- ▶ Loss of capital - less than 6 million
  
- ▶ What is the Secret of such a high return ?
  
- ▶ Its none other than



## CHECKLIST

Source : <https://www.youtube.com/watch?v=sLd6xtHaDnY#t=134>



## ❖ Checklist–Definition:

- ▶ In simple language checklist is- A Collection of points need to check before making investment.
- ▶ A checklist standardizes the process to ensure that all elements or actions are addressed.
- ▶ Some may have big (Mohnish Pabrai has 98-question checklist) or small checklist but the objective remains the same- that they don't want to miss the point they want to check.





## ❖ History of Checklist:

- ▶ The checklist has its genesis in 1935 when the U.S. Army received a new plane from Boeing. Boeing crashed and burst into flames soon after takeoff on its first flight. Why?



- ▶ It crashed because the experienced pilots forgot one important step (*Unlocking the rudder and elevator surface controls*) just one simple thing.





## ❖ History of Checklist:

- ▶ After the B-17 crash, Boeing survival was in question. So the Army and Boeing developed a pilot checklist.



- ▶ After the checklist was developed, the model never had another fatal accident due to pilot error. Today every airplane has such checklists and helps explain why aviation is as safe as it is.





## ❖ Process of Checklist:

- ▶ Checklist should have stuff we have learned from Graham, Buffett, Munger, Fisher, etc.
- ▶ Write down your thought process before investing
- ▶ Re-examine the company in which your rationale went wrong.
- ▶ Keep improving the checklist. As you learn continuously and situations change, you have to keep updating the checklist and make it better.



## ❖ Keep improving the checklist:

- ▶ Learn from your own mistakes.



Don't waste a good  
**mistake...**  
Learn from it.

- ▶ “Learn from the mistakes of others. You can never live long enough to make them all yourself.”

-Groucho Marx

**Dexter**  
SHOE COMPANY





## ❖ Does checklist really work?



"I'm a great believer in solving hard problems by using a checklist. You need to get all the likely and unlikely answers before you; otherwise it's easy to miss something important."

-Charlie Munger



"A checklist is like a circuit breaker that helps prevent the brain from being able to flip that switch."

- Mohnish Pabrai



"Good checklists, are precise. They are efficient, to the point, and easy to use even in the most difficult situations. They do not try to spell out everything"

- Atul Gawande



"You need different checklists for different styles of investing"

-Sanjay Bakshi

<http://www.valueinvestingworld.com/2014/04/charlie-munger-checklist-quote.html>

<http://blogs.wsj.com/moneybeat/2013/12/13/make-a-list-check-it-twice/>

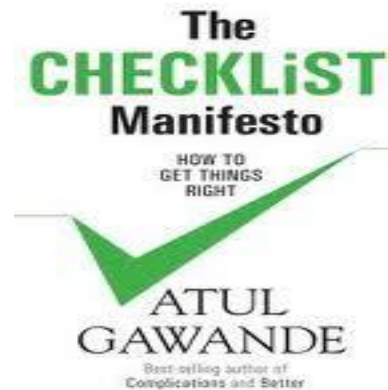
<http://blog.employeedevelopmentsystems.com/bid/102232/Stop-Asking-How-to-Increase-Personal-Effectiveness>

<http://www.takeurfile.biz/the-man-in-the-iron-mask-by-alexandre-dumas-2-2/>



## ❖ Does checklist really work?

- ▶ Recent bestseller - '[The Checklist Manifesto](#)' has discussed, many professions have reduced the risk of catastrophic failure complex decision-making processes by utilizing simple checklists.



- ▶ The noted value investor [Mr. Mohnish Pabrai](#) always advocates on use of checklist. So now Pabrai has a checklist that he ticks off before committing to an investment, similar to how a pilot checks off a list of variables before takeoff.



## ❖ Does checklist really work?

“*Checklist routines avoid a lot of errors. You should have all this elementary [worldly] wisdom and then you should go through a mental checklist in order to use it. There is no other procedure in the world that will work as well.*”

-- **Charlie Munger** – 2007 @ speech to the University of Southern California Law School

With the checklist in place, however, he observed that he could move through investment decisions far faster and more **methodically**.

-- **Mohanish Pabrai**- The Checklist Manifesto, page 169

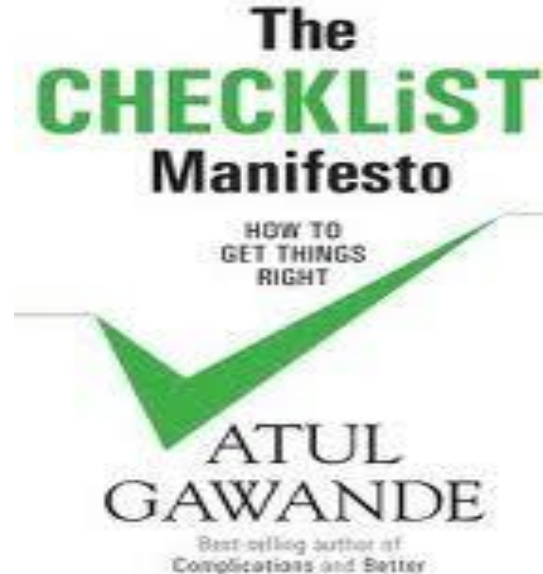
Source :

[http://www.valueinvestingworld.com/2007\\_05\\_01\\_archive.html](http://www.valueinvestingworld.com/2007_05_01_archive.html)



## ❖ Does checklist really work?

- ▶ Excerpt from "Checklist Manifesto" Showing checklist works in various industry aspect of life.





*“Under conditions of complexity, not only are checklists a help, they are required for success. There must always be room for judgment, but judgment aided – and even enhanced – by procedure.”*

– Atul Gawande

*“The construction industry’s checklist process has clearly not been foolproof at catching problems. Nonetheless, its record of success has been astonishing. In the United States, we have nearly five million commercial buildings, almost one hundred million low-rise homes, and eight million or so high-rise residences. We add somewhere around seventy thousand new commercial buildings, and one million new homes each year. But ‘building failure’ – defined as partial or full collapse of a functioning structure – is exceedingly rare, especially for skyscrapers. According to a 2003 Ohio State University study, the United States experiences an average of just twenty serious ‘building failures’ per year. That’s an annual avoidable failure rate of less than 0.00002 percent. The checklists work.”*

– Atul Gawande



*"In December 2006, the Keystone Initiative published its findings in a landmark article in the New England Journal of Medicine. Within the first three months of the project, the central line infection rate in Michigan's ICUs decreased by 66 percent. Most ICUs cut their quarterly infection rate to zero. Michigan's infection rates fell so low that its average ICU outperformed 90 percent of ICUs nationwide. In the Keystone Initiative's first eighteen months, the hospitals saved an estimated \$175 million in costs and more than fifteen hundred lives. The successes have been sustained for several years now – all because of a stupid checklist."*

– Atul Gawande

*"We have the means to make some of the most complex and dangerous work we do – in surgery, emergency care, ICU medicine, and beyond – more effective than we ever thought possible. But the prospect pushes against the traditional culture of medicine, with its central belief that in situations of high risk and complexity what you want is a kind of expert audacity – the right stuff. Checklists and standard operating procedures feel like exactly the opposite, and that's what rankles many people. It's ludicrous, though, to suppose that checklists are going to do away with the need for courage, wits and improvisation. The work of medicine is too intricate and individual for that: good clinicians will not be able to dispense with expert audacity. Yet we should be prepared to accept the virtues of regimentation."*

– Atul Gawande





Recently I've met three investors who have taken a page from aviation to incorporate formal checklists into their work. Mohnish Pabrai is managing partner in Pabrai Investment Funds in Irvine, California, and runs a \$500m portfolio; Guy Spier is head of Aquamarine Capital Management in Zurich, a \$70m fund; the third did not want to be identified or to reveal the size of the fund where he is a director. But it is one of the biggest funds in the world and worth billions.

Atul Gawande

***"What makes these investors' experiences striking to me is not merely their evidence that checklists might work as well in finance as they do in medicine. It's that here, too, they have found takers slow to come. In the money business, everyone looks for an edge. If someone is doing well, people pounce like starved hyenas to find out how. Almost every idea for making even slightly more money – investing in Internet companies, buying tranches of sliced-up mortgages, whatever – gets sucked up by the giant maw almost immediately. Every idea, that is, except one: checklists."***

– Atul Gawande

# ❖ Common thread between Military pilot, Doctor & Investment Manager – Checklist





## ❖ Common Checklist:

- ▶ The common thread between Doctor, Military pilot & Investment managers checklist:
- ▶ A set of questions or rules that apply to working or executing a procedure in a particular area be it Doctor ,Pilot or Investment manager.
- ▶ Keep on improving, it is a never ending process. As you learn continuously and situations change, you have to keep updating the checklist and make it better.
- ▶ Examine the mistake that led to death(doctor), plane crash(pilot) & permanent loss of capital(investment managers) and incorporate solution of that in check list.



## ❖ Why are checklists so effective?

- ▶ Flood of information- Easy to drown away or derailed.
- ▶ Disparity in method-Difficult to maintain a consistent investment process.
- ▶ Fallible nature of human-Role of checklists comes into play.





# ❖ Why are checklists so effective?

▶ Disciplined & Systematic.

▶ Avoid short cuts.

▶ Avoid herding behaviours.



## ❖ Why are checklists so effective?

- ▶ Keep emotions/Behavioural biases in check.



- ▶ Absolute cheapness bias-Missing the bigger picture.
- ▶ Allows review of decision – Can analyze trail to see where one went wrong.





## ❖ The disadvantages of checklist:

▶ Paralysis by analysis for starters.



▶ False sense of security.



▶ Emotionally painful.





## ❖ The disadvantages of checklist:

- ▶ Different checklist for every style, every single opportunity.



- ▶ All businesses will fail on some item on the checklist.



- ▶ Circle of competence bias- May escape taking efforts by saying that something is “out of my circle of competence”.



# ❖ Investment Guru's Checklist:





# ❖ Warren Buffett's Checklist:

*Never count on making a good sale. Have the purchase price be so attractive that even a mediocre sale will give good results*

## ➤ **Business:**

- Is the business simple and understandable?
- Does the company have Consistent operating history?
- Does the company have favorable long-term prospects?
- Does the company have strong Franchises with pricing power?
- Does the company have moat?



## ➤ **Management:**

- Is the management Trust worthy?
- Are the managers following lavish and extravagant styles?



# ❖ Warren Buffett's Checklist:

## ➤ Financials:

- Does the company have High Return on Equity (RoE)?
- Does the company have high and stable profit margins?

## ➤ Market:

- Are earnings estimates conservative?   
(Adjusting the discount rate for higher risk is not the best practice)



### References:

Warren Buffett – The making of an American Capitalist – Roger Lowenstein





The Warren Buffet way – Robert.G. Hagstorm

The Essays of Warren Buffett : Lessons for Corporate America by Warren E. Buffett

# ❖ Warren Buffett's Checklist:



## ➤ Companies to avoid:

- Does the co require a high degree of research-technology like pharmaceutical companies? 
- Does the company have a very long inventory cycle like farm (agricultural)? 
- Does the company have Cash guzzling business? 
- Is it a Commodities company (agricultural commodities particularly) -which are dependent upon the mercy of weather? 



## References:

[Warren Buffett – The making of an American Capitalist – Roger Lowenstein](#)

[The Warren Buffet way – Robert.G. Hagstorm](#)

[The Essays of Warren Buffett : Lessons for Corporate America by Warren E. Buffett](#)



## ❖ Peter Lynch's checklist:

*If one could tell the future by looking at Balance Sheets then Accountants and Mathematicians would have been the richest people in the world.*

- Small Market capitalized companies
- Fast growers (more than 30%,not sustainable growth)
- Slower-growth businesses
- Dull names, dull products, dead industry
- Boring businesses
- Spinoffs
- Insider buying and share buybacks

"Buying back shares," Lynch writes, "is the simplest, best way a company can reward its investors."

### References:

[One Up On Wall Street](#) : by Peter Lynch, John Rothchild  
[Beating the Street](#) by Peter Lynch, John Rothchild  
[Learn to Earn : A Beginner's Guide to the Basics of Investing and Business](#) by Peter Lynch, John Rothchild



## ❖ Philip Fisher's checklist:

- Is the company a Dominant Industry player?
- Does the company have Growth from existing Products?
- Does the company have High and expanding operating margins?
- Does the company have High ROCE?
- Does the company have Effective Sales and Research team?





## ❖ Philip Fisher's checklist:

- Does the company have Scalable business model?
- Is the company going for capacity expansion?
- Is there any bad corporate news about the company?  
(strikes, temporary failure of a new product)
- Is the company paying high dividend?  
(Higher rate of dividend shows inability to look for newer areas of growth)
- Does the company have low PE ratio ?





## ❖ Charlie Munger's Checklist:

- Do we understand the business?
- Does the business have an intrinsic value or a durable competitive advantage?
- Does management have high integrity? Do we respect and admire them?
- Reasonable Price?







## ❖ Mohnish Pabrai's checklist:

- Margin of Safety
- Is there a solid moat?
- Is it a simple easy to understand business?
- Are the revenues and cash flows of the business sustainable?
- Is the company's business becoming unregulated?
- Assets to Equity- is the company too leveraged ?



Source: <http://www.onefamilyblog.com/2011/10/mohnish-pabrais-views-on-how-to-buy-and.html>



## ❖ Mohnish Pabrai checklist:

- Could the company have bad lending decision ?
- How much will high unemployment and recession hurt the business?
- Is the investment correlated to one or more of your existing holdings?
- Can this business be decimated by low-cost competition from China or other low-cost countries?
- Is this a win-win business for the entire ecosystem?





## ❖ Mohnish Pabrai checklist:

### Management

- Management Compensation?
- Interests of Management – Is it aligned with shareholders?
- Management's historical track-record?
- Does Management have a large stake in the company?
- Does the company have union issues?



Source: <http://www.onefamilyblog.com/2011/10/mohnish-pabrais-views-on-how-to-buy-and.html>



## ❖ Ben Graham's 10 Point Checklist:

### ▶ Risk

1. Earnings to price (the inverse of P/E) is double the high-grade corporate bond yield. If the high-grade bond yields 7%, then earnings to price should be 14%.
2. P/E ratio that is 0.4 times the highest average P/E achieved in the last 5 years.
3. Dividend yield is  $\frac{2}{3}$  the high-grade bond yield.
4. Stock price of  $\frac{2}{3}$  the tangible book value per share.
5. Stock price of  $\frac{2}{3}$  the net current asset value.

Source : <http://myinvestingnotes.blogspot.in/2008/11/ben-graham-checklist-for-finding.html>



## ❖ Ben Graham's 10 Point Checklist:

### ▶ **Financial strength**

6. Total debt is lower than tangible book value.
7. Current ratio (current assets/current liabilities) is greater than 2.
8. Total debt is no more than liquidation value.

### ▶ **Earnings stability**

9. Earnings have doubled in most recent 10 years.
10. Earnings have declined no more than 5% in 2 of the past 10 years.

Source : <http://myinvestingnotes.blogspot.in/2008/11/ben-graham-checklist-for-finding.html>



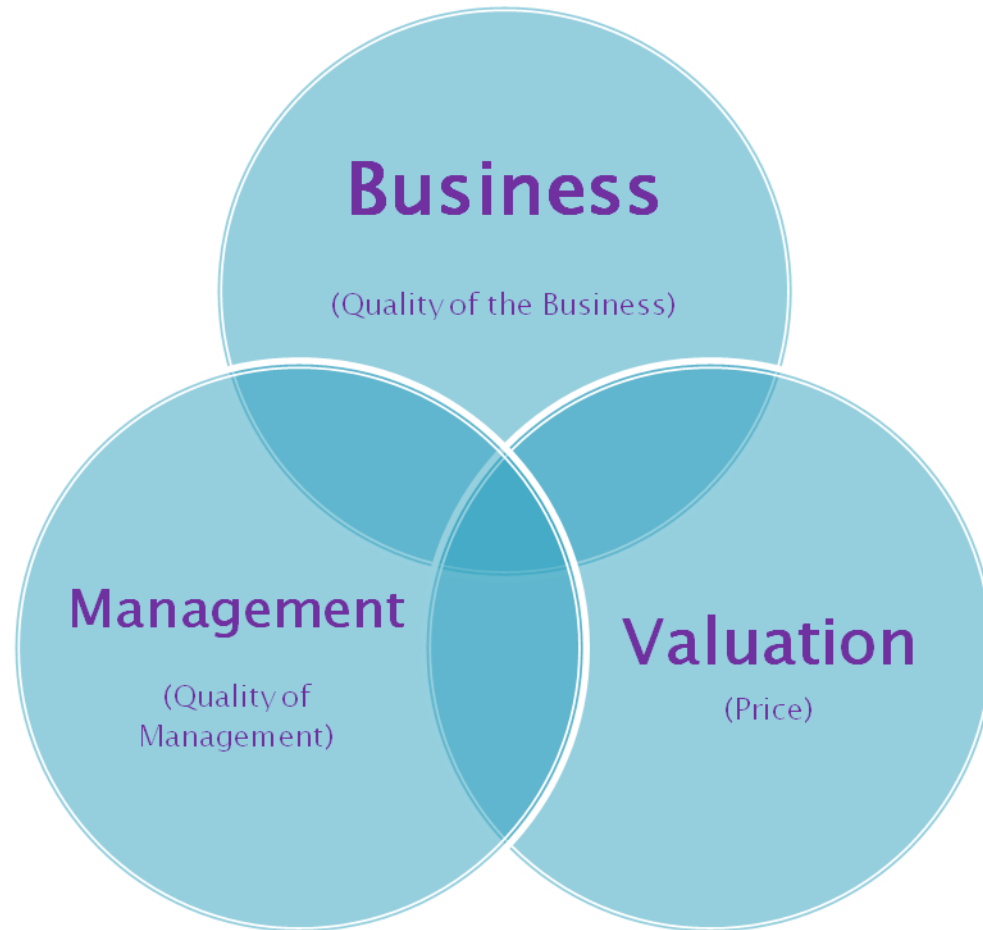
## ❖ Ben Graham's 10 Point Checklist:

- ▶ If a stock meets 7 of the 10 criteria, it is probably a good value, according to Graham.
- ▶ If you're income oriented, Graham recommended paying special attention to items 1 through 7.
- ▶ If you're concerned about growth and safety, items 1 through 5 and 9 and 10 are important.
- ▶ If you're concerned with aggressive growth, ignore item 3, reduce the emphasis on 4 through 6, and weigh 9 and 10 heavily.

Source : <http://myinvestingnotes.blogspot.in/2008/11/ben-graham-checklist-for-finding.html>



## ❖ Broader Point in Checklist:





## ❖ Business Model:

✓ **Is the business understandable? Simple Is Best.**

**Cera**

✓ **Restricted to "circle of competence" .**

~~**Pharma**~~

✓ **Big moat-sustainable competitive advantage**

**Nesco, Relaxo**

✓ **Does Company have Consistent & Long operating history ?**

**Nestle, HDFC  
Bank**





## ❖ Business Model:

✓ Does Company has Pricing Power ?

**ITC**

✓ Does Company generates Free floats ?

**NBCC, HUL,  
MT educare**

✓ Does company requires major and frequent capex ?

~~Glass industry,  
Textile~~

✓ Does Company has bargaining power with suppliers & customer?

~~Auto ancillary~~



## ❖ Business Model:

✓ Is regulation concern for the industry?

~~Sugar~~

✓ Is business Scalable?

~~Samtel India~~

✓ Can Chinese competition finish the business?

~~Electronics~~

✓ Does Company has Favorable long term prospects?

Page  
Industries



## ❖ Management tenets:

✓ Has management done frauds in past ?

~~First Leasing~~

✓ Does the company have good disclosure norms ?

Agrotech  
Foods Ltd

✓ Is the reputation of management good or bad ?

~~Piccadilly agro~~

✓ Is Management compensation too high?

~~Sun TV  
Network~~



## ❖ Management tenets:

✓ Is the company making sensible Capital allocation?

~~Satyam~~

✓ Higher promoter stake-Aligned with shareholders interest.

~~Vikas WSP Ltd  
(24.89%)~~

✓ Conflict of interest: Related party transactions.

~~Venkys~~

✓ Past treatment of minority investor.

~~EssarGroup~~

✓ Was the Management Honest during periods of adversity?

Hawkins



## ❖ Financial Tenets:

✓ High ROE/ROCE . See the trend over the last 5 years.

Symphony  
Ltd

✓ Does the company generate high operating cash flows?

~~Pantaloons~~

✓ Debt: Not too high relative to revenue & earnings

~~Arshiya~~

✓ Does the company pay sufficient tax or not ?

Kaveri?seeds

✓ Does the company holds unnecessary cash?  
(Indian cash or outside cash)

Nucleus  
Software



# Portfolio Construction....



# ❖ Portfolio Construction



“Keep all your eggs in one basket, but watch that basket closely”

**-Warren Buffett**



Diversification is a poor surrogate for knowledge, elements of control and price-consciousness

**- Marty Whitman**



“Allocate a relatively equal amount of capital to a large group of stocks with characteristics that over time tend to lead to superior investment results”

**-Benjamin Graham**



“Diversification is a safeguard against uncertainty and an essential feature”

**-Walter Schloss**

Source:<http://www.goodreads.com/quotes/616687-keep-all-your-eggs-in-one-basket-but-watch-that>

Source:<http://socialize.morningstar.com/NewSocialize/forums/t/214284.aspx>

Source:<http://basehitinvesting.com/warren-buffett-ben-graham-on-diversification-investment-philosophy-differences/>

Source:<http://www.scloss-value-investing.com/>

## ❖ Concentration

## vs. Diversification:



Carl Icahn's 32,928\$ million portfolio (Ichan Capital Management, LLP) contains only 19 stocks



Jeff Ubben's 13,244\$ million portfolio (Value Act Holdings, L.P.) contains only 9 stocks



Seth Klarman's 4,137\$ million portfolio (The Baupost Group) contains only 21 stocks



Edward Lampert's 2,169\$ million portfolio (RBS Partners, L.P.) contains only 5 stocks



Ron Baron's 24,549\$ million portfolio (Baron Funds) contains 362 stocks



Mario Gabelli's 18,525\$ million (GAMCO Investors) portfolio contains 841 stocks



George Soros' 10,117\$ million portfolio (Soros Fund Management, LLC) contains 305 stocks



Joel Greenblatt's 6,641\$ million portfolio (Gotham Asset Management, LLC) contains 994 stocks





- ▶ We can see investment guru's thoughts are divided between Concentration & Diversification.
- ▶ So, what should an investor follow?





## ❖ a few thoughts ....

- ▶ **Warren Buffett** clearly mentioned that **concentrated portfolios are not for everyone.**

“I have two views on diversification. If you are a professional and have confidence, then I would advocate lots of concentration. For everyone else, if it’s not your game, participate in total diversification.”



- ▶ "Key to success is not whether you can invest like Buffett, but whether you have investment philosophy that you are comfortable with."

**-Aswath Damodaran**



Source: <http://contrarianvalueedge.com/2013/06/24/diversification-beyond-allocation-2/>



# Capital Allocation/Bet Sizing....

## ❖ Sizing more important than selection

➤ Outcome of stock selection is probabilistic in nature

- It is impossible to be right all the time
- It is also impossible to be wrong all the time

Stock selection	Position sizing	Result
Right	Wrong (Insufficient allocation)	Unsatisfactory
Right	Right (Sufficient allocation)	Spectacular
Wrong	Wrong (Overallocation)	Disaster
Wrong	Right ( Low allocation)	Satisfactory

*Position sizing and not stock selection is the primary driver of portfolio returns*

## ❖ Where is it PRUDENT to bet big??

Probability of Downside	Probability of Upside
High	High
High	Low
Low	High
Low	Low

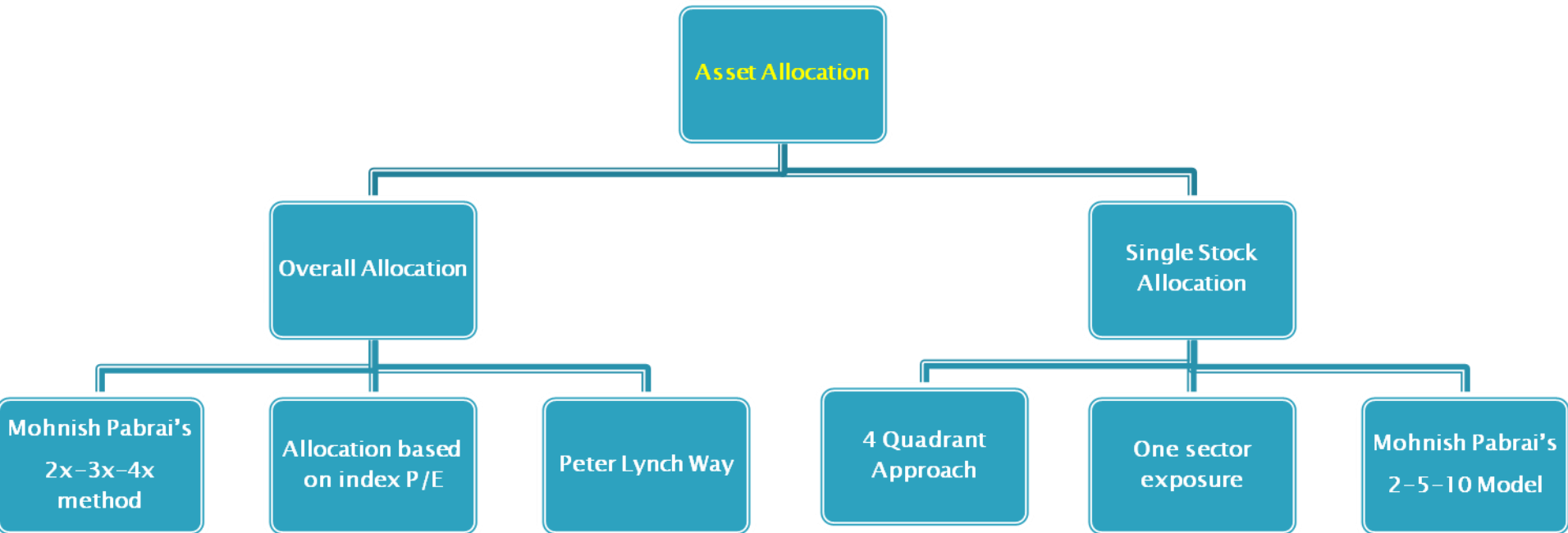
- High upside probability should have little to do with our sizing decision
- Large allocations should be made only when there is low downside probability
- Rule No. 1: Never lose money; Rule No. 2: Don't forget rule No. 1 – Warren Buffett
- The essence of investment management is the management of risks, not the management of returns – Benjamin Graham

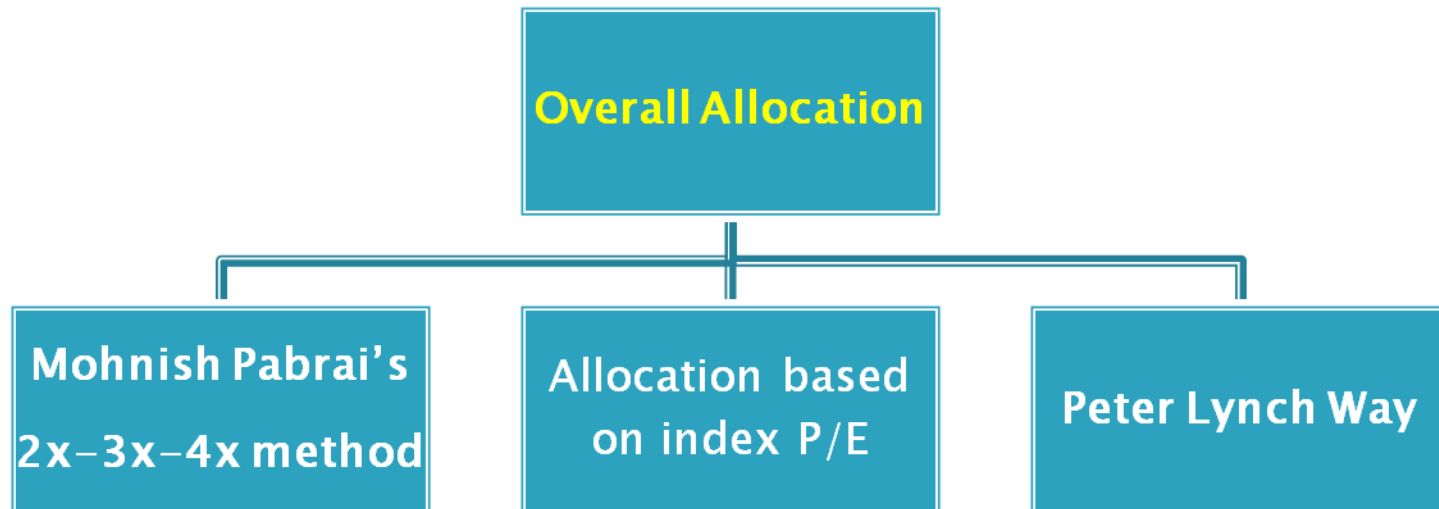
## ❖ Risk based sizing

- ▶ Risk is the permanent loss of capital, Never a number – James Montier
- ▶ Investment in moderate businesses with cheap valuations is riskier (higher probability for permanent losses) than investment in quality business at expensive valuations
  - Quality can also be a source of margin of safety
- ▶ “It’s far better to buy a wonderful company at a fair price than a fair company at a wonderful price.” – Warren Buffett



# ❖ Capital Allocation Framework









## ❖ Mohnish Pabrai way:

- ▶ Mohnish Pabrai's strategy for 26% annualized return (double in 3 years) states that:
- ▶ Do not invest in anything that does not look like a 2-3x in 2-3 years.
- ▶ Invest:-
  - 1st 75% of cash – minimum 2x in 2-3 years
  - Next 10% of cash – minimum 3x in 2-3 years
  - Next 5% of cash – minimum 4x in 2-3 years
  - Next 5% of cash – minimum 5x in 2-3 years
  - Last 5% of cash – more than 5x in 2-3 years

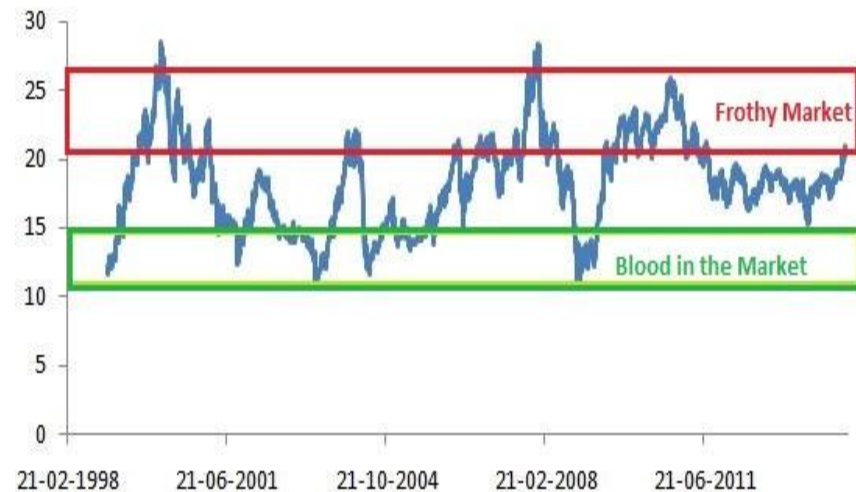


Source: <http://www.valueinvestingworld.com/2013/03/mohnish-pabrai-columbia-compounding.html>



## ❖ Allocation based on index P/E:

- ▶ In the “**Frothy Market**” we tend to be extra careful as we might become more optimistic by market sentiment. To avoid that we try to hold extra cash in our portfolio.
- ▶ On the contrary when Nifty P/E comes into 10-15 range, we tend to follow the famous saying of Nathan Rothschild “**Buy when there’s blood in the streets**”. In this situation, we stick to our conviction by convincing ourselves that world is not over.



Source: <http://freefincal.com/dynamic-asset-allocation-mutual-funds-yield-gap-vs-pe-ratio/>

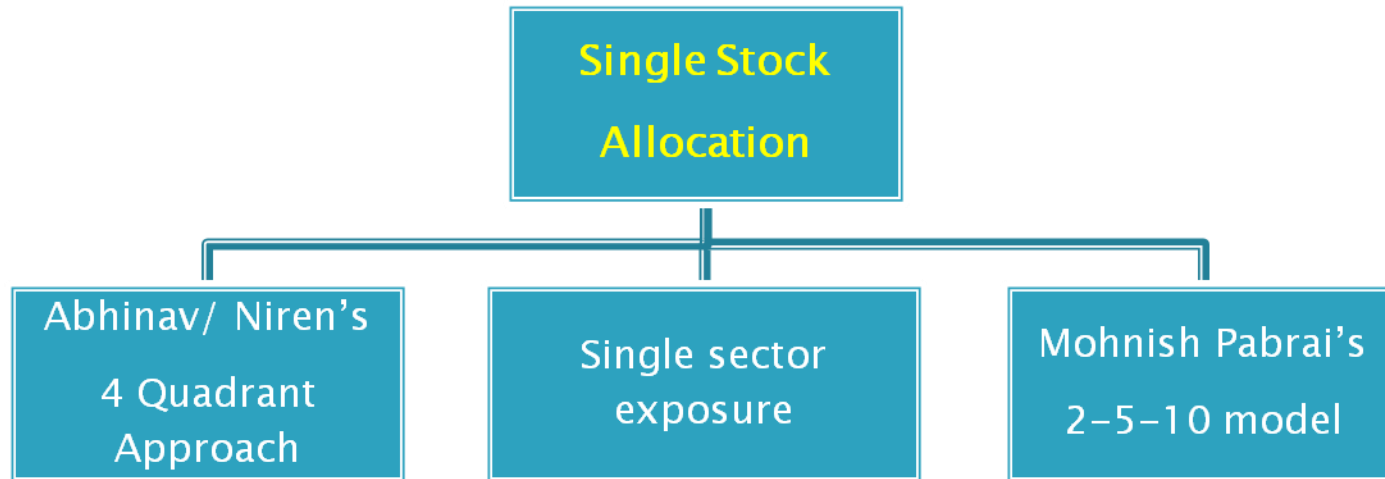


## ❖ Peter Lynch Way:

- ▶ If you are looking for Ten baggers, the more you own the more likely the chance of getting Ten baggers.
- ▶ The more stocks you own, more flexibility you have to rotate funds between them.
- ▶ Peter Lynch says allocate:
  - 10-20% in stalwarts (Reliable & trustworthy)
  - 10-20% in cyclical (Depends on business cycle)
  - Rest in Turnaround
- ▶ He also said not to put 30-40% of asset in growth stock.



Source: Peter Lynch, One up on Wall Street





# ❖ 4 Quadrant Approach:

Bad  
Valuation

**Deceptively Easy  
(BB)**

Do not allocate any  
amount

**Pay up for quality, but  
Don't forget growth  
(GB)**

Allocate 2%-5% of the portfolio

Bad  
Business

Good  
Business

**Smokers Corner  
(BG)**

Allocate **no more** than  
2%-3% of the portfolio

**Quality at a discount  
(GG)**

Allocate 5%-7% of the portfolio  
It helps to guard against the  
mistake of underweighting

Good  
Valuation

Source: <http://manufacturedluck.blogspot.in/2014/04/fools-wisdom-4-alternate-approach-to.html>



## ❖ How this method helped us:

- ▶ We used to start with the valuation of company, rather than looking into the business quality. For example: **IFB industries** (Highly competitive business)
- ▶ After going through the 4-quadrant approach, we started to evaluate company first on quality & then on valuation basis. If required we will wait for right price. Example: **AgroTech Foods limited, Zydus Wellness**
- ▶ Warren Buffett's quote on similar context -  
**"Time is the friend of the wonderful company, the enemy of the mediocre"**  
source: <http://www.brainyquote.com/quotes/quotes/w/warrenbuff384032.html>
- ▶ We generally invest in those companies that lie in the good business quadrants ( First & Fourth quadrants)



## ❖ Limiting exposure to one Sector :

- ▶ Pat Dorsey mentioned

Spreading your risks around applies to larger categories--such as sectors, market caps, and styles--in addition to individual stocks. Any time you find that too much of your portfolio is in one area of the market, then you've probably got yourself some good sell candidates.

Source:<http://news.morningstar.com/articlenet/article.aspx?id=106836>





## ❖ Ways to allocate in a Single sector:

- ▶ One way of allocation is to invest in a single company of single sector  
Example: Asian Paints in Paints industry

OR



- ▶ Another way is to identify top 2-3 companies of a industry & invest accordingly in each stock.  
Example: Buying CRISIL, ICRA in credit rating sector
- ▶ Here we need to consider not to highly concentrated in a single sector. Sometimes some incident/regulation may bring down the whole Sector.  
Eg. US credit rating sector scare after the Enron fiasco.





## ❖ 10-10 model to 2-5-10 model:

- ▶ After the 2008-2009 crisis, Mohnish Pabrai switched from 10x10 model to more diversified 2-5-10 model.

- ▶ **10-10 model:**

10 stocks are invested approx at 10% each.

- ▶ **2-5-10 model:**

- 2% of funds to reasonably undervalued positions
- Up to 5% of funds to exceptional opportunities
- Up to 10% of funds but only **“if seven moons line up.”**
- Always hold around 10% in cash to capitalise opportunities during market crash





## ❖ We humbly tried to analyse 2-5-10 model further:

Measurement of Metrics	Allocation of Portfolio
<ul style="list-style-type: none"><li>• Coattail smart investor's choice that have sensible story and price closer to his purchase price</li><li>• Wonderful past track record of business</li><li>• High ROC with understandable business</li><li>• Decent promoter record, no capital misallocation &amp; promoter stake is decently high or increasing</li><li>• Reasonable valuation</li></ul>	2%
<ul style="list-style-type: none"><li>• Accessible management that maintains high disclosure norms and/ or keeps con-calls</li><li>• Sustainable ROC and Moat</li><li>• Very high Size of Opportunity &amp; high Ability to capture it and reinvest future cash flows</li></ul>	go upto 5%
<ul style="list-style-type: none"><li>• Cheap Valuations</li></ul>	As high as 10%



# ❖ Position Sizing– Risk Management Ed Seycota way:

- ▶ Here we can introduce “**risk management**” concept given by Ed Seycota.
- ▶ Ed Seycota is an MIT graduate who pioneered the System trading concept. During 1972 to 1988, he increased one of his client's account from 5000 USD to 15 Million USD with CAGR approx 65%.



Source: [http://tradersonline-mag.com/01\\_ezine/01\\_traders/en/2012/09/files/assets/basic-html/page55.html](http://tradersonline-mag.com/01_ezine/01_traders/en/2012/09/files/assets/basic-html/page55.html)

- ▶ Position sizing can be calculated on three factors:
  1. Portfolio size
  2. % of total portfolio, investor wants to risk
  3. Maximum expected loss as per investors estimate per stock

Source: [https://www.youtube.com/watch?v=Ywd\\_VK4\\_FxE](https://www.youtube.com/watch?v=Ywd_VK4_FxE)



## ❖ Continued...

- ▶ Investment in one stock :  $(\text{Portfolio size} * \% \text{ of risk}) / \text{Maximum loss as per investors estimate per stock}$
- ▶ For example ,

<b>Allocation of Stock A</b>	
Portfolio Size	50,00,000 INR
Market price of stock	80 INR
Acceptable loss in % term	3.00 %
Maximum loss as per investors estimates on each stock	30 INR
No. of stocks to buy for portfolio	$(50,00,000 * 3\%) / 30$ = 5,000
% of portfolio invested in stock A	$(5,000 * 80) / 50,00,000$ = 8.00%

- ▶ He should allocate 8% of his portfolio in stock A



## ❖ What we follow:

- ▶ We personally do not cross 10 % allocation cap in any single stock.
- ▶ And final allocation decision is taken by considering lower figure of the Mohnish Pabrai's 2-5-10 model & Ed Seykota's risk management model.
- ▶ For example applying Ed Seykota method suppose we reached the figure of 8% for both in Noida toll bridge & MT Educare.

Then as per our current model, one might not go higher than 5% in Noida toll bridge. Because as per 2-5-10 model, growth opportunity is not high for this company.



## ❖ What to do if stock price dives further:

- ▶ We will not buy more further more than the allocated % decided earlier, till the stock crosses maximum acceptable loss limit. In our example if stock A goes below 50 INR we will start buying again.
- ▶ But we will buy till the maximum allocation i.e. 10% as per Mohnish Pabrai's 2-5-10 model.
- ▶ However, this further buying will strictly depend on further conviction, availability of cash and lack of other opportunity.



## ❖ But why not beyond 10% ?

- ▶ Why we are sticking to only 10 % allocation of the portfolio where

Charlie Munger is more than 60% invested in only Wells & Fargo

Source: <http://www.gurufocus.com/StockBuy.php?GuruName=Charlie+Munger>

Warren Buffett invested more than 40% of his portfolio in only American Express after Salad Oil Scandal in 1963

Source: <http://www.iwarrenbuffettquotes.com/warrenbuffett-americanexpress/>

- ▶ For us it boils down between “I Know” and “I don’t Know” camp

# ❖ “I Know camp” vs. “I don’t Know camp” :



## I Know Camp

Higher ground work with higher conviction enables “I know Camp” for higher allocation.

## I Don’t Know Camp

Although having high conviction, “I don’t Know Camp” can not neglect uncontrollable uncertainties like

**Natural disaster-** 2011 nuclear disaster caused more than 70% fall in Tokyo Electric Power stock.

**Promoters death-** Cera’s promoter’s son Mr. Vidush Somany passed away at the age of 31

What would happen to Thomas Cook, if something wrong were to happen to Mr. [Prem Watsa](#)

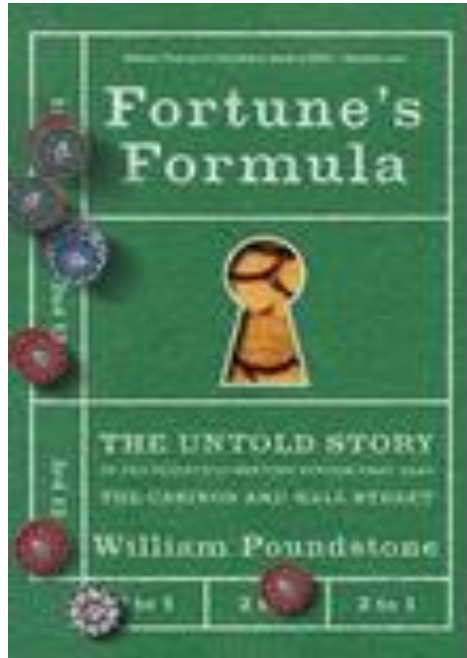
We tilt more towards “**I Don’t Know**” camp

❖ Source – Kuntal Bhai, Abhinav





## ❖ Kelly's Criterion:



- ▶ John Kelly, scientist of Bell Labs, is known for formulating the ***Kelly Criterion***.
- ▶ This formula says when the odds are good, one should bet a higher percentage of one's bankroll.
- ▶ *It is proportional betting system where each wager is scaled to current size of bankroll.* But should not be as high that any kind of loss leads to bankruptcy.
- ▶ All great investors use this formula, either implicitly or explicitly. For example when Warren Buffett managed much smaller sums of money back in the '60's, he is known to have placed up to 40% of the portfolio in a single stock.

Source: <http://seekingalpha.com/article/250811-the-kelly-formula-growth-optimized-money-management-not-for-the-faint-of-heart>

Fortune's Formula

# Checkout/When to sell

Because every stock is a sell at a particular 'price'





## ❖ Checkout– An Introduction:

- ▶ Checkout is nothing but a decision when to cut ties to a stock .
- ▶ The decision to sell a stock is a combination of art and science.
- ▶ However, the dilemma is when to sell a stock?
- ▶ Most investors focus more on when to buy and forget the other side of the coin which is when to sell.
- ▶ Selling is even more difficult than buying a stock.



Source: <http://forbesindia.com/column/column/the-art-of-selling-stocks/27282/1?id=27282&pg=1>

❖ Views of investment guru's on checkout:



# Love is Eternal

# Love is till I find next better one



My favourite  
holding period is  
forever

**-Warren Buffett**



If the job has been  
correctly done  
when a common  
stock is purchased,  
the time to sell it is  
almost never

**-Philip Fisher**



Either sell once  
you're up 50% or  
sell in two years,  
whichever  
happens first

**-Benjamin  
Graham**



Each year we buy  
stocks and they go  
up, we sell them  
and then we try to  
buy something  
cheaper

**-Walter Schloss**

Source:<http://www.brainyquote.com/quotes/quotes/w/warrenbuff129835.html>

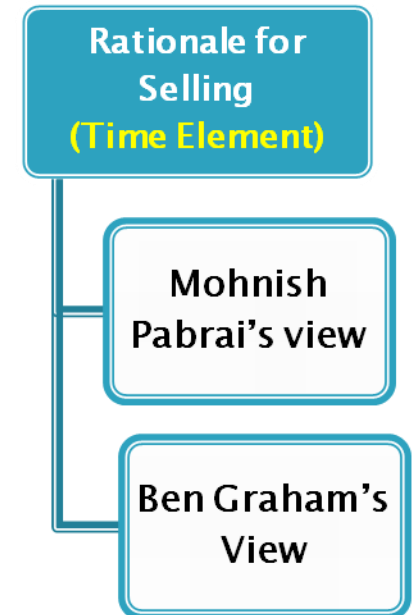
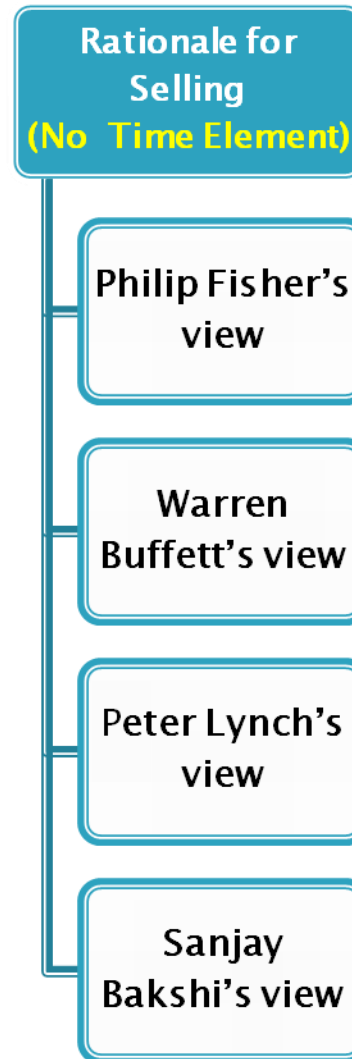
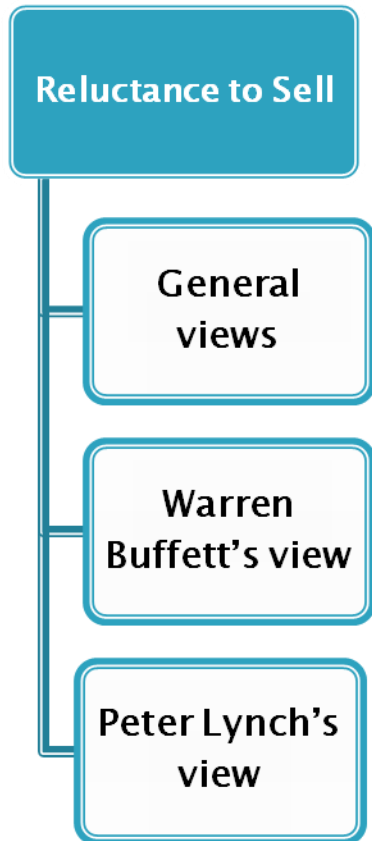
Source:<http://www.incademy.com/courses/Ten-great-investors/Philip-A-Fisher/3/1040/10002>

Source:<http://www.dailywealth.com/2467/guide-for-selling-stocks-from-the-father-of-value-investing>

Source:<http://sharesandstockmarkets.com/89-awesome-value-investing-quotes-from-walter-schloss/>

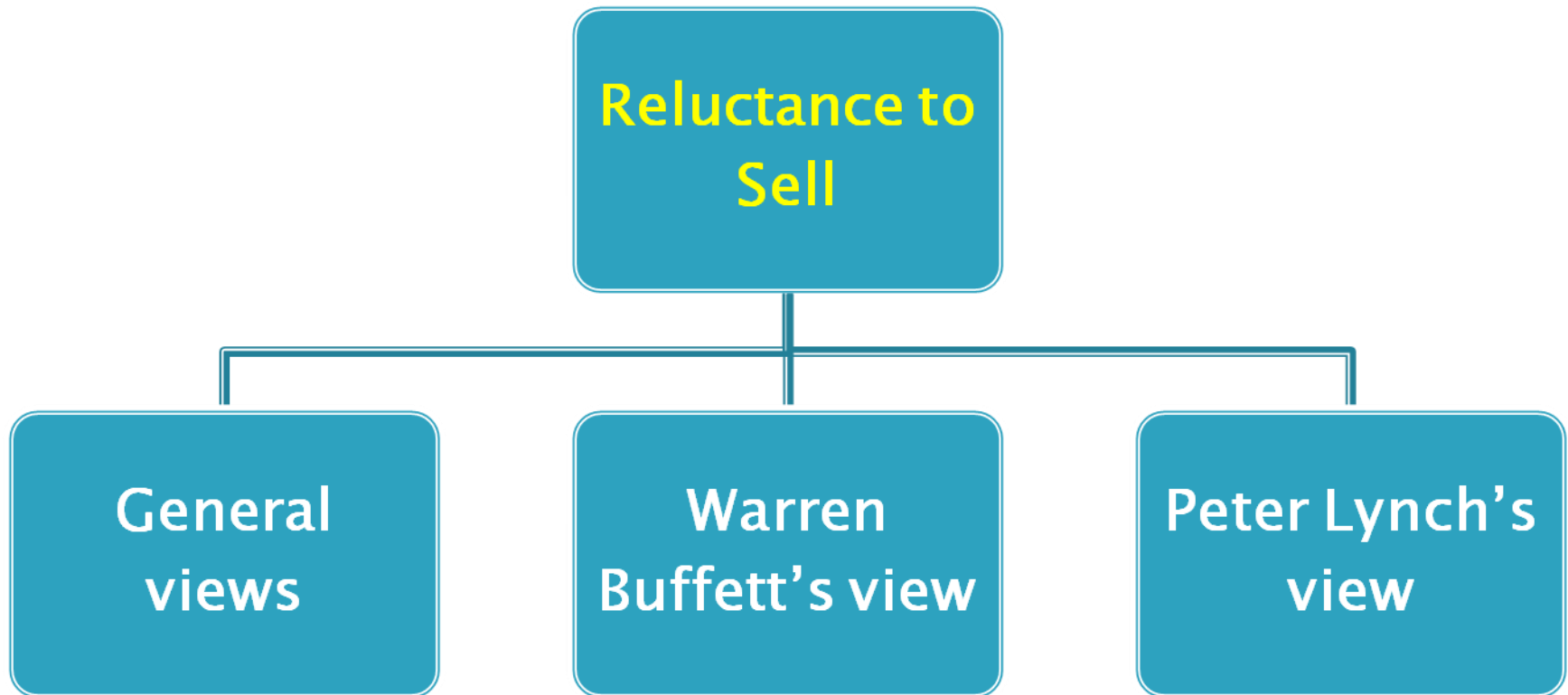


# ❖ Checkout Camp:





## ❖ Reluctance to Sell:





## ❖ General Views :

- ▶ **Mental Accounting** – When buying cost is very nominal compared to the current market price, investor becomes reluctant to sell as he thinks that price will never fall back to the buying price.

मैंने तो Cera 200 रुपये में खरीद रखा है

मैंने तो ITC 10 रुपये में खरीद रखा है

- ▶ **Regret Bias** – To avoid feeling sorry, when value stocks like Page Industries goes up after selling.



- ▶ **Tax-** बेचने से डर नहीं लगता साहेब, **TAX** से लगता है-- अभी तो **long term** होना बाकी है

Source: <http://forbesindia.com/column/column/the-art-of-selling-stocks/27282/1?id=27282&pg=1>





## ❖ Warren Buffett's View:

“My favourite holding period is forever”

- Warren Buffett

### **Warren Buffett 1996 letter to shareholders:**

When we own portions of outstanding businesses with outstanding managements, our favourite holding period is forever.

We are just the opposite of those who hurry to sell and book profits when companies perform well,

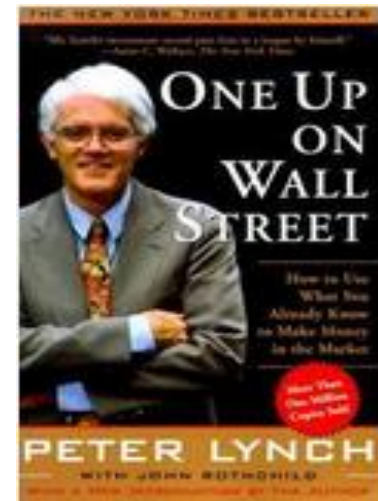
*But we are also the opposite of those who tenaciously hang on to businesses that disappoint.*

Source: <http://www.investingdaily.com/14729/warren-buffett-on-when-to-sell-a-stock/>



## ❖ Peter Lynch's View:

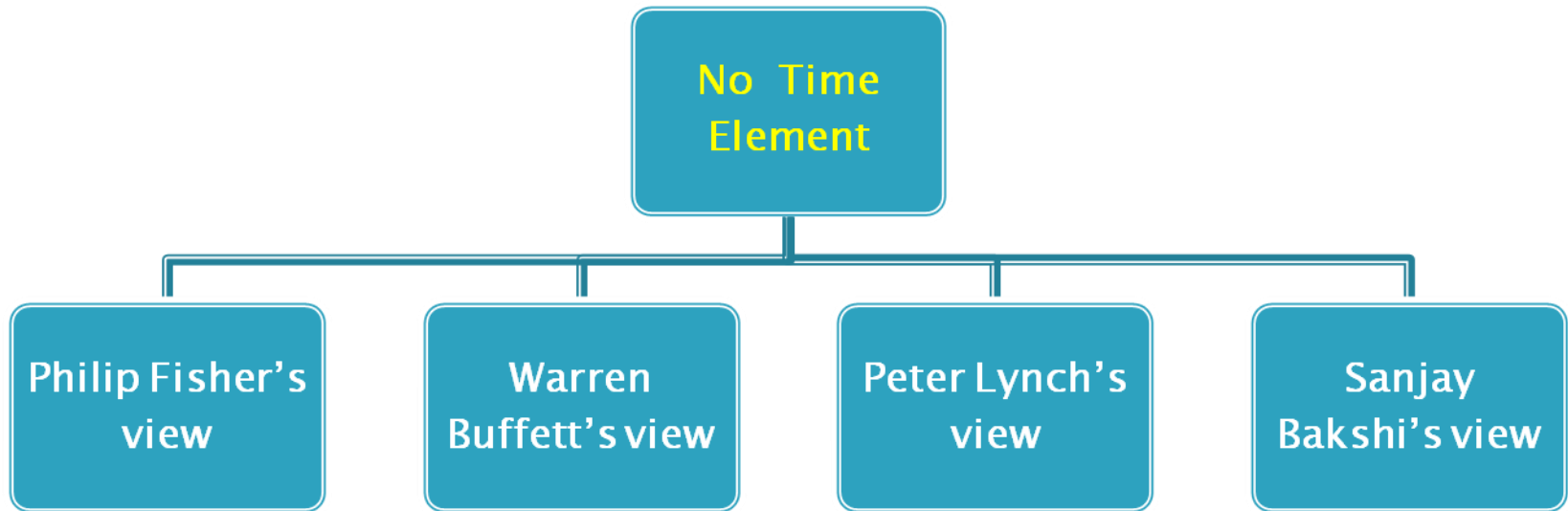
- ▶ When you have found the right stock and bought it, all the research tells you its going higher and working in your direction then its bad if you sell.



Source: Peter Lynch, One up on Wall Street



# ❖ Rationale for Selling:





## ❖ Philip Fisher's view:

According to Mr. Fisher there are only three reasons (barring any personal reasons) for which one should sell a stock:

### ▶ **When one has made a mistake**

Satyam Computers before Mr. Ramalinga Raju admitted for committing a massive fraud.

### ▶ **When the reasons why investor bought the stock are no longer valid:**

If investor is attracted because of a particular manager and he is no more with the firm.

**Ajay Piramal** (bet on Piramal is bet on Mr. Ajay Piramal)



If investor bought the stock for an event & that did not materialize.

**Halonix Ltd.** (de-merger)



## ❖ Philip Fisher's view:

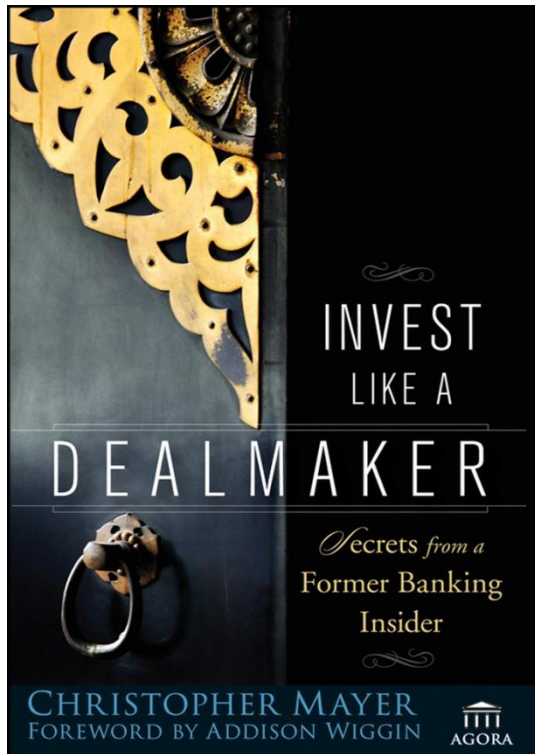
### ▶ When one believes that one can get better returns in another stock:

If investor believes that the growth prospect of some other company may be better than the one whose shares he already owns, he should reallocate the fund.

However, with this switching of fund there is also the possibility that some major element in the overall picture may have been overlooked. If this is the case, the new investment is required to be studied more carefully and to be given reasonable time.



## ❖ Warren Buffett 's view:



- ▶ **Buffett sells under three conditions if:**
  - 1) The business is broken in some way and no longer meets his criteria.
  - 2) He needs more money to fund an even better opportunity.
  - 3) He realizes he has made a mistake.



## ❖ Peter Lynch's view:

- ▶ If you know why you bought a stock in the first place, you will automatically have a better idea of when to sell.
- ▶ **Time to think about selling when:**
  1. Analysts giving the highest stock recommendation
  2. 60% of the shares are held by Institutions
  3. Magazines and Newspapers have fawned over the CEO
  4. Acquisitions of unrelated businesses



Source: <http://socialleverage50.com/2013/09/02/20-insights-from-peter-lynch/>



## ❖ Sanjay Bakshi's view:

- ▶ The Moat is not enduring any more.
- ▶ Management is no longer both competent and honest.
- ▶ If the Moat is still enduring and love the management, but I found something significantly better in terms of expected returns.
- ▶ **When upper estimate of expected return is less than AAA bond yield, not worth to own a stock.**

Before the sell decision, you have to keep making these periodic evaluations to determine if you're happy with the business and the management.

Source: <http://webcache.googleusercontent.com/search?q=cache:http://www.safalniveshak.com/value-investing-sanjay-bakshi-way-2014-part1/>



## ❖ Relaxo Model:

Hypothetical figures



Parameters	As per Prof. Bakshi Model	Parameters	Increase in stock price
Market Cap*	₹8.6 bn	Market Cap	₹29 bn
Earnings	₹4.6 bn	Earnings	₹4.6 bn
Exit P/E	15	Exit P/E	15
Future Market Cap#	₹69 bn	Future Market Cap	₹69 bn
CAGR	23%	CAGR	9.05%
AAA Bond Yield	9.14%	AAA Bond Yield	9.14%

When Stock CAGR > AAA Bond Yield, No need to sell.

When Stock CAGR < AAA Bond Yield, It's time to sell.

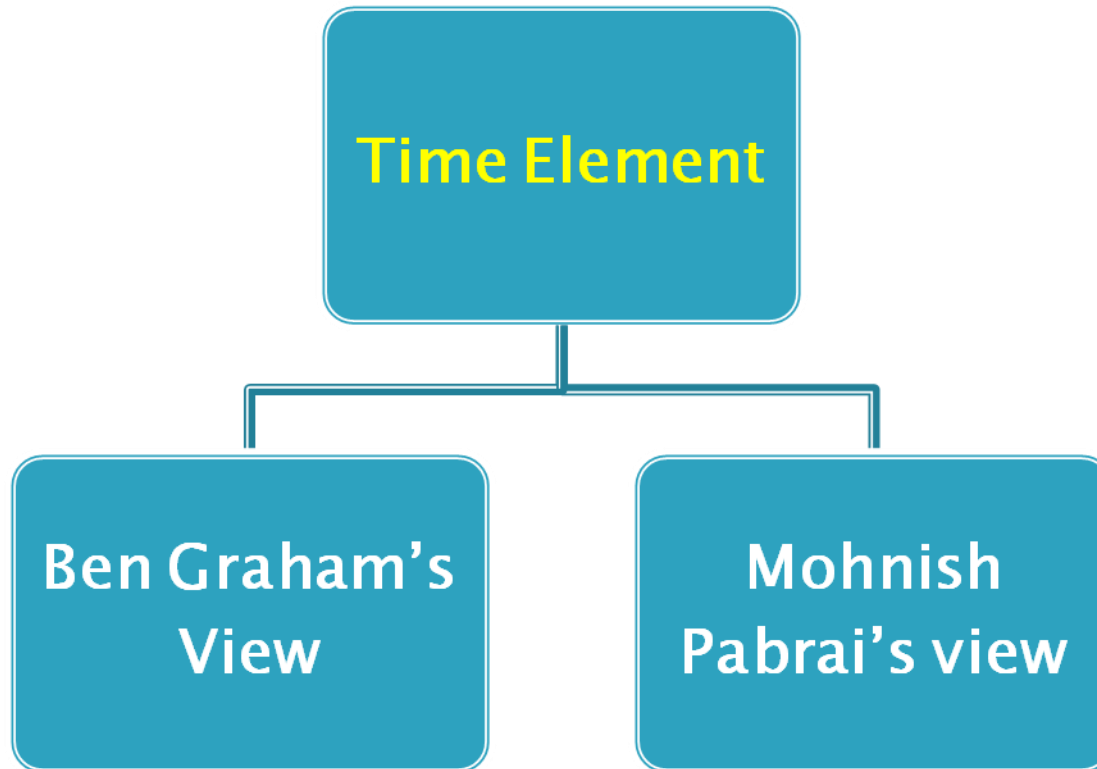
\*In September, 2013 and # 2023

Source Yield- [http://www.business-standard.com/article/finance/bond-yields-to-range-trade-in-anticipation-of-budget-and-monsoon-jajoo-114062900681\\_1.html](http://www.business-standard.com/article/finance/bond-yields-to-range-trade-in-anticipation-of-budget-and-monsoon-jajoo-114062900681_1.html)

Source: [https://dl.dropboxusercontent.com/u/28494399/Blog%20Links/Relaxo\\_Final.pdf](https://dl.dropboxusercontent.com/u/28494399/Blog%20Links/Relaxo_Final.pdf)

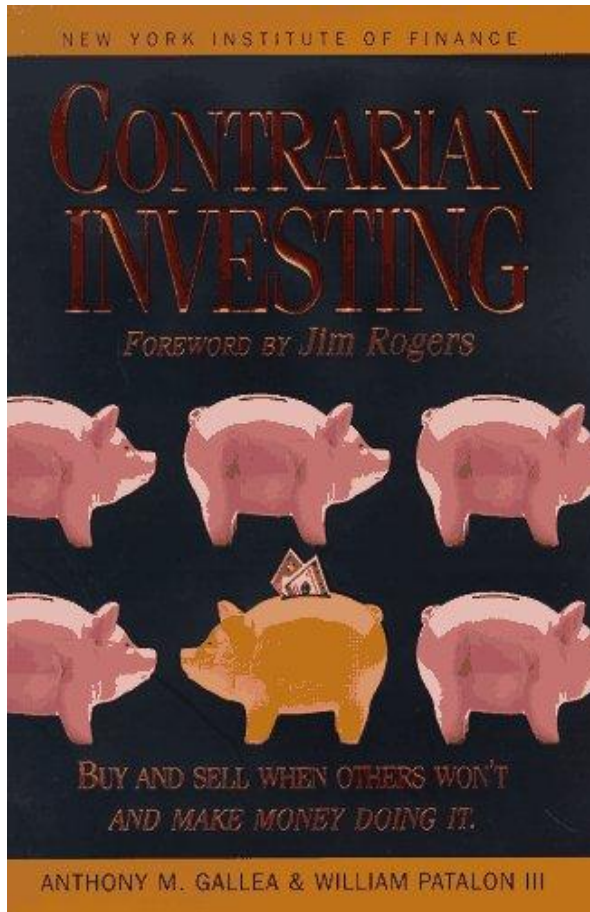


## ❖ Rationale for Selling:





## ❖ Ben Graham's view:



- ▶ According to Ben Graham, a stock should be liquidated after a 50 percent profit, or 24 to 36 months from purchase, whichever comes first.

## Contrarian Investing



## ❖ Mohnish Pabrai's view:

- ▶ Mohnish Pabrai says one should have patience while investing in the stock market and a time frame of at least 2-3 years is imperative.
- ▶ The three-year rule also allows us to exit a position where we are simply wrong on our perception of intrinsic value.

**If we didn't have an out and always waited for convergence to intrinsic value, we may have an endless wait. There is a very real cost for waiting. It is the opportunity cost of investing those assets elsewhere.**



## ❖ What we think:

- ▶ The last point seems interesting however we try to stick to the performance metrics of the stock rather than the price movement.

For example: Although till March 2014, MT educare did not move much from its IPO price (80 INR), we like to hold it because of its performance metrics .

	2014	2013	2012
Revenue	185.43	158.96	132.37
Growth	16.7%	20.1%	-
EBIT	33.12	25.85	20.22
Growth	28.1%	27.8%	-
PAT	21.99	18.36	13.77
Growth	19.8%	33.3%	-
ROE	19.5%	22.67%	24.61%
ROCE	30.63%	32.08%	35.26%

## ❖ Relevance of position sizing in sell decision:



- ▶ Mental Accounting – When buying cost is very nominal compared to the current market price, investor become reluctant to sell as he thinks that price will never fall back to the buying price.
- ▶ While buying the stock, investors look at certain parameters but when it comes to selling they just compare their Historical Cost with Current Market Price and if CMP is much higher than historical cost, they continue to hold it.



## ❖ Has the stock become too large part of your portfolio?

- ▶ Any time one stock grows to become more than 10% of your portfolio, you should start thinking very carefully about how much risk you're taking on--even if you still think a company has great prospects.
- ▶ It's simply not prudent to allow it to take up too large a percentage of your portfolio.



~Pat Dorsey



## ❖ How do we reconcile sell decision with position sizing:

- ▶ Lets take a hypothetical example of **Cera Sanitary ware Ltd.**
- ▶ BUY – 325 ( 5% of portfolio)
- ▶ NOW –1300 (17.4% of portfolio)

### Checklist

- ✓ Expected return > Bond Yield
- ✓ Investment thesis
- ✓ Reasons for Buying Cera
- ✓ Management quality
- ✓ Moat present in the business



Position Sizing

(-)ve  
Black  
Swan

Yes

Take your Capital  
Out

No

Stay Invested





## ❖ Checkout Strategies – Black Swan Companies:

- ▶ Financial Companies that operate on high leverage are considered Black Swan companies. E.g. Financial Banking Institutions (Lehman Brothers)

Muthoot Capital	Figures	Calculation steps
Investment(x)	8% of Portfolio	
Buy Price	Rs 80 per share	Initial total Portfolio = Rs 1000 (Rs 80 included)
Required Return	15% per year	
Current Market Price(2x)	Rs 160 per share	Current total Portfolio = Rs 1080
Holding Period	1 year	
Check out	Invested capital with Required Return	
Capital & checkout with return	Rs 92	Capital Rs 80+ Return Rs 12
Remaining invested amt	Rs 68	Rs 160- Rs 92
Position free of cost	6.3% of portfolio	$(68 * 100) / 1080$

Assuming all other stocks of the portfolio have not moved.



## ❖ Sleep Test– Am I able to sleep comfortably?

At the end, forget all the arithmetic. If you are not able to sleep at night peacefully (thinking about your position),



bring your investment down to a comfortable level that passes the “good night sleep” test.



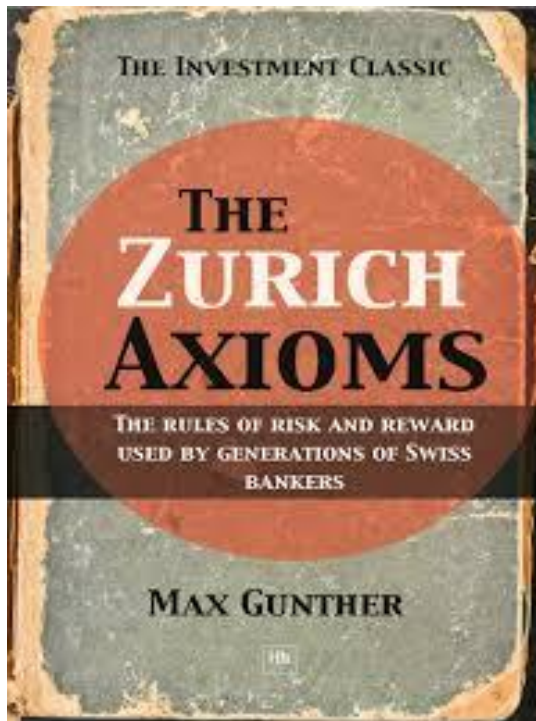
Source:

[http://www.hughestrustco.com/articles/take\\_the\\_ability\\_to\\_sleep\\_at\\_night\\_test.html](http://www.hughestrustco.com/articles/take_the_ability_to_sleep_at_night_test.html)



❖ Some more generic points from books:

## The Zurich Axioms:



- ▶ Be careful. Don't let those roots grow too thick to cut.
- ▶ Decide in advance what gain you want from a venture, and when you get it, get out.
- ▶ When the ship starts to sink, don't pray. Jump.

# ❖ Donald L. Cassidy

( A Senior Research Analyst with Lipper Inc., a Reuters Company)

- ▶ **The Irrelevance of personal cost price**

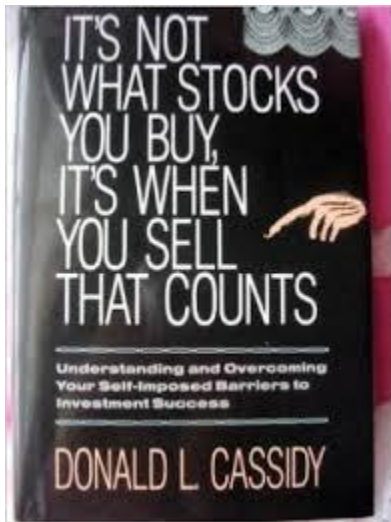
The historic accident of one's buy price becomes psychological baggage great personal magnitude. And almost always , its effect is detrimental to the eventual execution of a successful sale.

- ▶ **Separate the Stock and the Company**

While the company is wonderful but the valuations are not good.

- ▶ **Ego Factor**

When the investor has made his ownership position known to others, it becomes difficult for him to change his stance.



❖ Do you have any Questions, comments or concerns?



Please feel free to contact me with any unanswered questions, suggestions & ideas.

- [ashishkila@gmail.com](mailto:ashishkila@gmail.com)
- +91-9999751327

### **Perfect Research**

T-24A Green Park Extn.

New Delhi - 16

Blog: <http://perfectresearch.blogspot.in>

Twitter: @ashishkila