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Rajeev Agrawal on Key Lessons Learned Over the Past Year

This article is an edited excerpt of an annual letter by MOI Global instructor Rajeev Agrawal, founder and managing partner of DoorDashi Advisors, based in New York.

Rajeev is an instructor at Asian Investing Summit 2021.

Warren Buffett's animated series, The Secret Millionaires Club, has a catchy tagline, *"The more we learn, the more we earn."* We are on a journey to learn and earn!

Another important consideration is that the biggest returns from compounding are all back-ended. Warren Buffett made his first Billion at the age of 56. All the remaining billions he has made, and many more that he has given away, have been accumulated from that first billion at the age of 56. Similarly, what we will do in our future years will have an even bigger impact on what we will achieve.

Hence, we should continue to learn and improve. How do we learn continuously? It pays to listen to Charlie Munger on this subject, *"I know I'll perform better if I rub my nose in my mistakes. This is a wonderful trick to learn."* The lessons below are our effort at rubbing our nose in our mistakes. Hopefully, we will remember them better.

The best time to buy a stock is when there is blood on the street, even if the blood is your own

March of 2020 left most investors bloodied and bruised. There was no place to hide. We were no different. We would wake up, see our holding go down another x% for the day and go back to bed. Next day was no different. Do look at the chart again (earlier in the letter) to see how swift and deep the fall was!

My wife rightly diagnosed that I wasn't sleeping well. I knew I was not. However, I told her I was sleeping soundly so as not to spread the panic that I was feeling inside. Everything that we owned was in free fall.

Many investment managers that I spoke to during March told us how they have moved 50% of their portfolio to cash or are in the process of raising cash to a very high proportion. Most investment managers also talked about another down leg in the coming months.

Such market moves, and response from investment managers, left me numb. Yet when we looked at our portfolio holdings, we were seeing something totally different. Expected returns in many of our holdings looked unbelievably good even under pessimistic scenarios.

Our investment approach gave us the courage to be active buyers with the cash that we had. I am glad we did. It helped us do much better than the benchmarks.

Of the various stocks that we bought during the March period, we put out a thesis for a few in the public domain. Thesis on KRBL was presented in MOI Global Asian Investing Conference as well as submitted on Sumzero in late March and early April. We were already invested in

KRBL when March came. However, when the stock tanked we loaded up on it. It has worked out very well so far.

A good business and good management, at a bad price, is not a good stock

The ten-year bull market in technology stocks has fuelled the narrative that investing is all about finding good businesses and good management. Price doesn't matter.

Trees don't grow to the sky no matter the soil and the care with which they are looked after. Similarly, a company won't keep growing, forever, at very high rates and prices do matter. Resistance can come from unknown quarters including government policies, company's bureaucracy, industry development, business environment or even a virus!

We had such an experience with a company called Piramal Enterprises in 2018. We liked the management of Ajay Piramal – a good capital allocator. We liked that they are going into business areas where there is a lot of white space and hence a long runway. However, as the business performed, the price ran far ahead of the fundamentals.

We knew that the price didn't justify the fundamentals. However, we were intoxicated by what can happen a decade out rather than what could happen in the next few years. Mr Market gave us a whacking and a lesson that we will try to remember for the future.

The misplaced craze for compounders

Another narrative which has developed with the bull market is that one needs to find Compounders and hold them for multiple decades. This narrative talks about how FANGAM (Facebook, Amazon, Netflix, Google, Apple, Microsoft) has rewarded its shareholders. However, what the narrative misses is how many such "perceived" compounders have failed in the past as well. Think of Nokia, Yahoo, General Electric, Myspace and many more.

Unfortunately, compounders are only known in hindsight. However, one is managing the portfolio for the future. Thus, buying and selling of a stock should be done based on our assessment of the business prospects and the valuation. It should be done irrespective of tax consequences and frictional costs associated with the activity.

Ian Cassell wrote an interesting article recently where he talked about how portfolio turnover is the price of progress. He mentioned, *"Peter Lynch had a 300% turnover per year in the early years of the Magellan Fund. Joel Greenblatt had similar turnover at Gotham Capital. Even Warren Buffett's public company portfolio ranged between 50-100% turnover per year during his first three decades."*

We had carried low turnover as a "badge of honour" in the past. However, over time we have realized that low turnover is not the goal, good returns are!

Portfolio allocation is key

Unless one actively guards, a lot of trifles get collected in the portfolio which doesn't add

much to the portfolio but take away a lot of time. It is important to get rid of them as soon as one realises that there are trifles in the portfolio.

We realized that while our portfolio grew multi-fold over the last seven years, we had not proportionately increased our buying/selling of the position to account for the increased size of the portfolio. Hence, we were ending up with sub-optimal allocation to positions.

We instituted a simple rule to correct for the above: There will be no position in the portfolio unless it is >1% of the portfolio. The only exception is if the position is being actively sold, being actively bought or if we want to "watch" it closely.

To some 1% may seem too small a position. However, the conviction in a new position comes over time. So we will take baby steps in a new position and gradually build our conviction over time.

Diversification versus concentration

One of the key questions in investments is the level of concentration in one's portfolio. When we started we preferred a concentrated approach with having most of our allocation in the top ten positions. While there is no right answer our thoughts continue to evolve here.

We now prefer to have a diversified portfolio for the same expected return-risk profile of securities. This viewpoint reflects our experience that occasionally stocks move wildly without a corresponding change in the business outlook. Having a diversified portfolio allows us to take advantage of these moves.

However, we will not diversify our portfolio for its own sake. New positions have to provide a compelling return-risk profile to get into the portfolio. We need to be comfortable with our understanding of its business and management. Lastly, we metaphorically ask these positions to justify "why they should be in our portfolio?"

Mistakes are a sign of progress if you are learning from them

While in 2018 we did beat the indices (but not our internal benchmark), in 2019 we underperformed the indices. We are glad that in 2020 we are now out of the woods and beating the industry benchmarks and, more importantly, our internal benchmark

2018 and 2019 gave us a lot of opportunities to think about and learn from. While many lessons outlined here remind us of the corresponding pain that it caused, we are glad that we went through it. We are even happier that we talk about them with our investors and through that improve ourselves and (possibly) our investors.

If we take the right lessons from life and investing then the inferior part of life is the "earlier part". Ray Dalio puts it succinctly, *"Pain + Reflection = Progress."* Charlie Munger has elaborated further, *"Any year that passes in which you don't destroy one of your best-loved ideas is a wasted year."* By Charlie's measure, we have been on a fruitful journey!

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Dare to be different, and right

Too many investors and too many institutions run towards the positions that have done well recently and, out of positions that have gone down. There is no denying that momentum in stocks is alive and well. Understanding who is buying and selling stock and why can provide important insights.

However, insight on incremental supply and demand of a stock is only a start. It is even more important to have an understanding of the business, the management incentives and, the competitive landscape.

IDFC's stock price had gone only one way since 2010 – down! Nobody wanted to talk about it. It was a pariah. Most investors were selling it as soon as they were getting even! Due to the fall, the stock had turned compelling which drew our attention to it.

On our investigation, we found that Management was hugely incentivized and management talk and action had been consistent. There was a regulatory trigger point as well. In June 2020, we put out a thesis of why we like IDFC on Sumzero. We also gave a few talks – talk 1 and talk 2 – in which we discussed IDFC and other ideas in brief.

So far IDFC has worked out well. It is up more than 100% since we put out the thesis 7 months back. Being willing to be different and right can be very rewarding! However, being different also entails the risk of being wrong. We have the scars to show for our audacity. In the words of Lou Brock, one of baseball's best players of the late 1960s, *"Show me a guy who's afraid to look bad, and I'll show you a guy you can beat every time."* We don't want to be that guy!