Honesty and Integrity Investment (HNI Investment)

Email for Sep 2017

Dear Friends,

Here are the details of performance of HNI investment based on the share prices as on 30th Sep. 2017.

Annualised Returns (IRR) (1) (2) (3)	HNI Portfolio	Nifty	Sensex
FY13	-10.6%	-5.3%	-3.7%
FY14	112.2%	21.1%	21.3%
FY15	21.6%	25.0%	23.0%
FY16	86.0%	-7.0%	-7.7%
FY17	168.3%	21.9%	20.1%
From Inception till 30th June 2017	**85.3%**	**12.9%**	**12.0%**
From Inception till 30th Sep. 2017	***85.0%***	***13.5%***	***12.4%***

(1) For all HNI clients and promoters (2) Inception was in August 2012 (3) Gross IRRs excluding the impact of HNI investment fees

We continue to outperform the markets. We also completed one more exit during the quarter which was initiated in the last quarter. On this exit we generated an IRR of 220.8% (1.1 year holding period). We continue to face the deployment problem with no more investments during the quarter. We are just left with 2 stocks in the portfolio (I wonder whether I should call it a portfolio ☺). Promoter's equity exposure has reduced to just around 15% of the net worth. In fact asset under management (AUM) is now negligible but then who cares. Should we start caring about AUM, we will be in trouble… big trouble. As I have explained again and again, this situation is not a conscious decision. If we can get the comfort around protection of capital in the chosen stocks, we will invest irrespective of the broader market situation.

On that note, let me pick a new interesting topic for our discussion. It relates to recent changes in the behaviour of the retail investors in India. Let's call it "The Gordian knot of retail investors".

The Gordian knot of retail investors

The great retail investor is pouring money into stock market through mutual funds like never before. They come in whenever recent stock market performance is good. They go away whenever the recent performance is bad. This has been the case across market cycles. This tendency of retail investors is widely believed to be the main cause of their historical poor experience in the stock market. However there are few important differences this time.

First, large amount of equity flows into mutual funds are now in form of Systematic Investment Plans (SIPs). In fact in August and September 2017, SIP inflows have crossed INR 5000 crore a month, a number that seemed unbelievable few years ago. This change in trend towards SIPs is due to the significant regulatory changes that SEBI has brought over years in asset management companies and mutual fund distribution business. Since SIPs are monthly EMI kind of flows from bank accounts, they are presumed to be sticky.

Second, unlike earlier cycles, in this cycle whenever market corrects, retail investors pour more money into mutual funds. In other words, they are showing the signs of having been shifted to contrarian strategy from momentum strategy. During March 2015 to Feb. 2016 when markets corrected by around 21%, they invested 78000cr, a growth of 32% over the same period a year earlier. Recently in two months of August and September 2017 amid North Korean missile crisis, they invested record 37,500cr (a massive growth of 300% over August and September 2016). Unbelievable!!! This contrarian behaviour is due to a) bad experience that they had with momentum investing in earlier market cycles (and consequently the revelation of apparent benefits of contrarian strategy) and b) fear of missing out (FOMO). In hindsight, most of us regret not investing in the crash of 2008/09!! In the slowdown of 2011-13!!.

These are important changes in the behaviour of the retail investors. It is widely believed among the investment community that these changes are good for the retail investors and will provide them superior experience from the investments in the equity market. Unfortunately, this is not necessarily true.

First let me clarify on SIPs. Well doing SIPs is definitely better than trying to time the market. No doubt about that. But would it mean that not timing the market is the sole condition to generate good returns? Who said that? Anybody?. In fact retail investors these days are systematically doing the wrong thing i.e. investing at higher valuations. Systematically doing the wrong thing will not make it right. It's not about how you do it (systematically or unsystematically). It's actually about what you do (whether you invest right or wrong). They are currently choosing to be systematically wrong than unsystematically right.

But, i still believe that if the retail investors continue their SIPs for 10 years or more (and do not touch it in between); they will get satisfactory results (and not more). If you start your SIPs at a higher valuation and higher valuation continue for long time then to derive satisfactory results, a) your holding period has to be long (and very long) for those tranches to show the benefits of compounding and b) you need long period of undervaluation to make your average valuation better. Both of these will probably happen if you continue your SIP for long period of time. But the big question is "if". Are SIPs as sticky as investment community believes?. Unlike EMIs which is a compulsive repayment of a liability, all of us can stop SIPs at a click of a button. It again boils down to one hard feature of the character – Discipline. If the small retail investors had the discipline they would neither be small nor the retail.

Secondly, retail investors are not only doing SIPs, they are also choosing to be contrarian. But again it's not about momentum or contrarian investing, it's about rational investing. In fact when the whole crowd believes in contrarian investing; then that itself becomes a momentum. ***Warren Buffet said "A contrarian strategy can be as foolish as a momentum strategy".*** This is a lesson many retail investors still needs to learn. Unfortunately they will because as ***he said "What the wise man does in the beginning, the fool does in the end".***

But the good thing is that the retail investors are not fools. No No No they are not. They know that they do not know enough about the stock market and that they need advisors to guide them. That's the reason they are investing heavily this time through advisors like mutual funds. It is up to the advisors to look into their own long term interest. They should be in the same boat.

I hope HNI will be able to place itself well in this gap… and untie the Gordian knot…simply my acting in its own long term interest. I hope…..

That's it from my side. Feel free to get in touch with me if you have any questions on the investment performance.