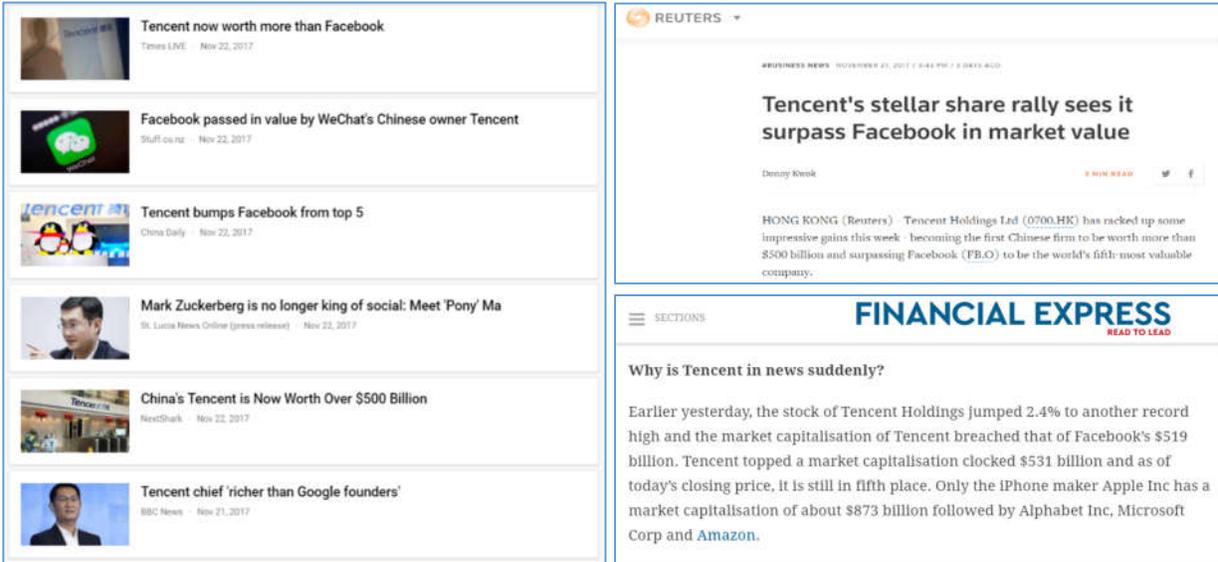


The Painful Multibagger

November 2017

Recent news flow around China’s Tencent Holdings surpassing Facebook by market capitalisation was almost unmissable. In a matter of a few years, a company known primarily to Chinese investors gained recognition across the globe. The stupendous rise of more than 500x in the share price of the company over the last ~14 years (since its listing in June 2004) would have left a lot of investors envious, for it is not often that we come across multibaggers of this magnitude (CAGR of ~59%).

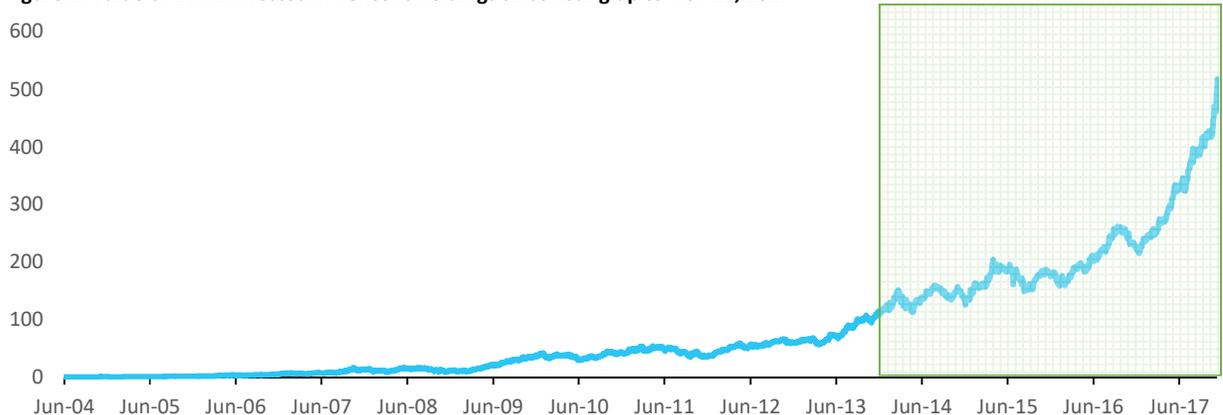
Figure 1: Recent news flow on Tencent Holdings



Source: Google, Reuters, Financial Express

The following chart depicts the value of one rupee invested in the shares of Tencent Holdings on its listing (*assuming throughout this document that the underlying share prices are in INR, for simplicity*).

Figure 2: Value of INR 1 invested in Tencent Holdings since listing up to Nov 21, 2017

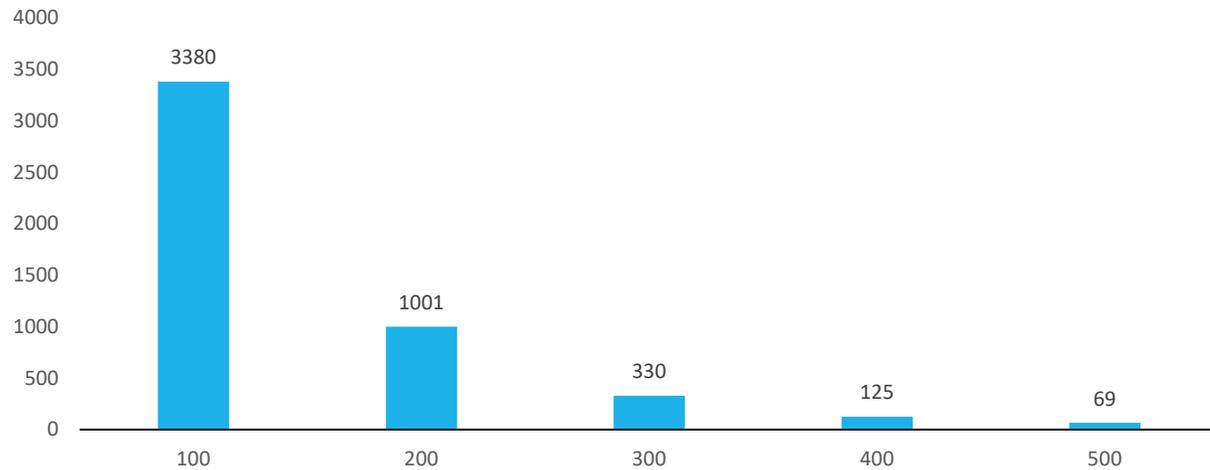


Source: Yahoo Finance, Tamohara

One often wishes when looking at such a chart that one could go back in time and invest in that security. To buy and hold is a tenet that is the easiest to preach with the benefit of hindsight. While a 500x return or a 59% CAGR sounds stupendous (and outlier, in our opinion), we argue that even with the benefit of hindsight, not many investors would be able to ride such a journey.

Notice how a large part of the stock returns came in a short period of time, especially towards the end of the period. That's the power of compounding at work. To put this into perspective, around 80% of the value (400 out of 500) was realised in a short period of around 4 years, compared to the holding period of 14 years.

Figure 3: Number of days taken to add incremental INR 100 of value by Tencent Holding shares

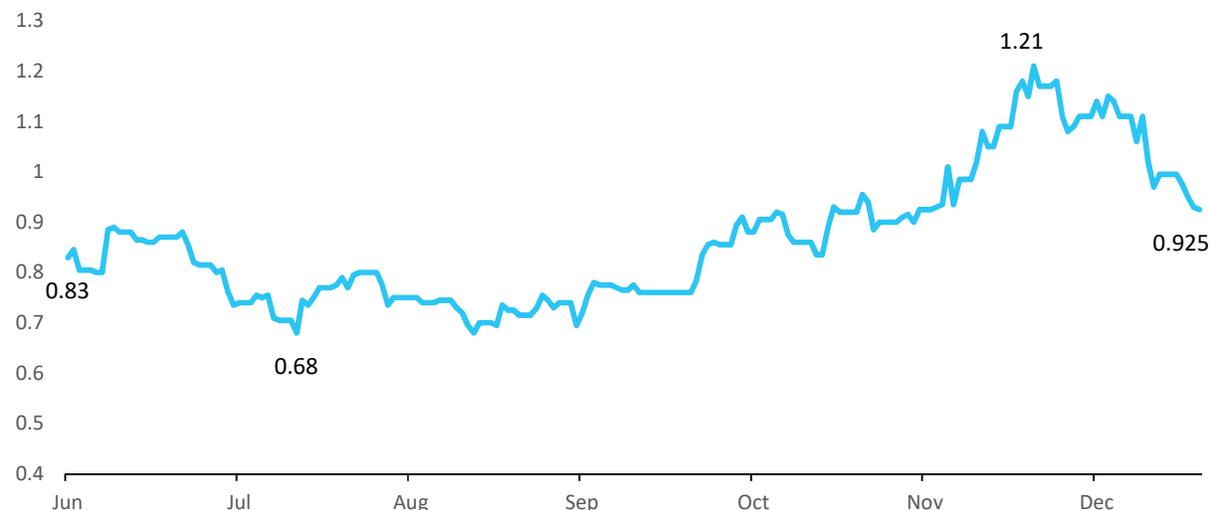


Source: Yahoo Finance, Tamohara

Good things, as they say, come to those who wait. But how many of us would have had the patience to sit tight for 14 years? Had returns been steady and linear, some of us may have exhibited patience (the operative word being 'may have'). However, asset prices are seldom steady and linear, especially equity prices.

Consider this: Let's say that you invested in the shares of Tencent Holdings upon listing, only to see the share correct by around 18% to 0.68 levels in less than a month. From here on, the share price remains range bound around these levels for the next two months, before gaining around 80% to 1.21 levels in the two months after that. However, once again, the share price corrects, this time by around 23% to close the year at 0.93 – a gain of around 12% since listing.

Figure 4: Share price performance of Tencent Holdings during calendar year 2004, after listing

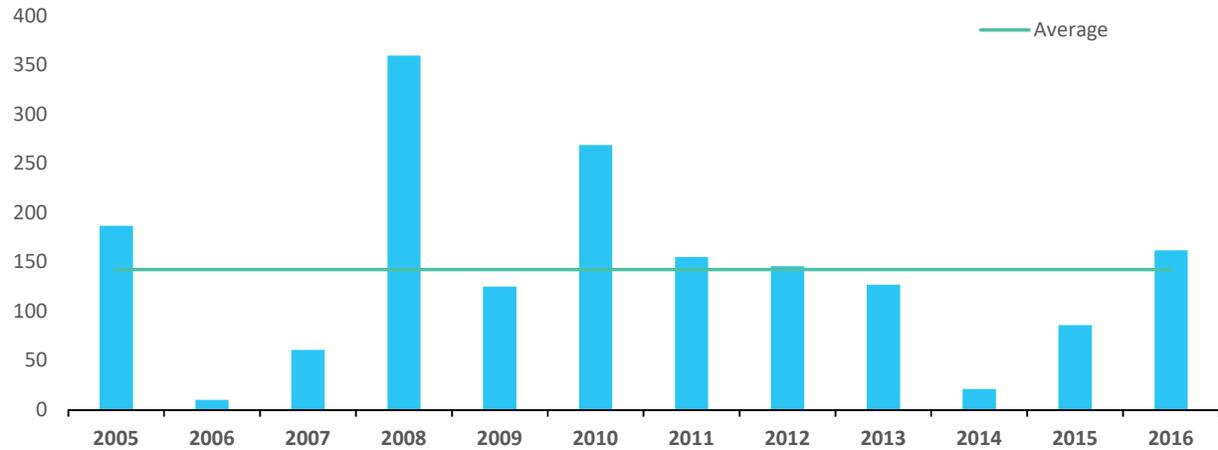


Source: Yahoo Finance, Tamohara

This topsy-turvy ride would not have been the most comfortable to bear as an investor. In fact, most investors would have been disappointed with 'losing' 23% of value from the peak at year end (In ['The Fallacies of Our Mind'](#), we had highlighted how we value loss twice as much as we value gain). What if this was a regular

feature of the share price in all but three years till date? That is, in most years, the stock price ended the year anywhere between 10% to 30% lower than the peak price recorded during the year. In fact, in each of the years during its listing, the stock price traded below its previous year's peak price for an average of 142 days – well over a quarter. Thus, not only did an investor see his/her year end price to be lower than the peak achieved during the year, but they continued to witness that for well over a quarter in the subsequent year on average. Without the benefit of hindsight, how comfortable would you have felt holding such a security?

Figure 5: Number of days that share price remained below the previous year's peak price



Source: Yahoo Finance, Tamohara

So far, we have only discussed the volatility in share prices. All businesses go through up and down cycles. Add to it street expectations of earnings, competitive developments, negative publicity, etc. and the psychological pressure of owning a stock only multiplies.

Figure 6: Examples of negative press coverage on Tencent Holdings

<p>HOME > BIZ > GLOBAL</p> <p>JULY 4, 2017 4:21AM PT</p> <h3>Tencent Loses \$14 Billion After Criticism From Chinese Media</h3> <p>By Vivienne Chow</p>	<h3>Tencent stripped of antivirus rankings for cheating on tests</h3> <p>Another week, another Chinese firm accused of gaming system</p>
<h3>China Targets Tencent's Top Earner in Game Addiction Warning</h3> <p>Warning from</p> <p>Aug 6, 2017 12:36 AM GMT+8:00 (Updated on July 4, 2017 11:59 PM GMT+8:00)</p>	<h3>China Accuses Its Top 3 Internet Giants of Potentially Violating Cybersecurity Law</h3> <p>Tencent, Baidu, and Sina are being investigated by the Chinese Cyberspace Administration.</p>
<h3>Uber CEO accuses Chinese messaging app WeChat of censorship</h3> <p>Chief executive Travis Kalanick claimed messaging app WeChat, whose owners invest in Uber rival Didi Kuaidi, blocks Uber-related news</p>	<p>Two chatbots have been pulled from a Chinese messaging app after they questioned the rule of the Communist Party and made unpatriotic comments.</p> <p>The bots were available on a messaging app run by Chinese Internet giant Tencent, which has more than 800 million users, before apparently going rogue.</p>
<p>shanghai</p> <h3>Tencent apologises to Apple CEO Tim Cook for calling him a "sufferer of homosexuality"</h3> <p>BY BERNHETT TAN IN NEWS ON AUG 31, 2015 5:19 AM</p>	

Source: Internet

Please note that the above images are for educative purpose only, and are in no way a reflection of our views or by any means an attempt to malign the reputation of the company. Every business faces criticism at some point. The limited point that we are driving is that when such criticism is coupled with a fall in share prices, investor convictions are heavily tested. Especially when average investment horizons are falling across the

globe. The following chart shows how the average holding period has moved in the US. While data for Indian investors isn't easily available, using mutual fund turnover ratios as proxy, we surmise that, in general, holding periods in India are also not very high.

Figure 7: Average Holding Period for NYSE stocks



Source: Ned Davis Research, as reported by www.nasdaq.com

Figure 8: Mutual Fund turnover ratios

Fund	Portfolio turnover (%)	AUM (Rs Cr)	Fund	Portfolio turnover (%)	AUM (Rs Cr)
Edelweiss Large Cap Advantage Fund - Reg	352	144.11	Edelweiss Equity Opportunities Fund Reg	140	260.62
Edelweiss Prudent Advantage Fund - Reg	284	14.68	Axis Long Term Equity Fund	134	14,362.68
Aditya Birla Sun Life Pure Value Fund	260	1,617.51	Kotak Classic Equity Reg	130.83	111.81
ICICI Prudential Dynamic Plan	250	7,382.30	Edelweiss Economic Resurgence Fund - Reg	116	25.61
Baroda Pioneer Midcap Fund	235	34.33	ICI AXA Equity Fund - Reg	105	88.79
IFIL India Growth Fund - Reg	233	424.47	Axis Midcap Fund	105	1,231.42
DHFL Pramerica Diversified Equity Fund - Reg	209	80.64	Mirae Asset Tax Saver Fund - Reg	109	547.22
Baroda Pioneer Large Cap Fund	206	28.02	Axis Focused 25 Fund	108	1,825.35
Peerless Equity Fund	204	123.15	LIC MF Equity Fund	107	338.02
Edelweiss ELSS Fund - Reg	190	70.08	Reliance Tax Saver (ELSS) Fund	107	9,042.28
ICICI Prudential Long Term Equity (Tax Saving)	179	4,440.18	SBI Bluechip Fund	104	15,569.99
Baroda Pioneer ELSS 96 Fund	172	108.94	DHFL Pramerica Midcap Opportunities - Reg	101	140.97
ICICI Prudential Multipack Fund	171	2,812.31	Reliance Growth Fund	98	6,614.14
Reliance Top 200 Fund - Retail Plan	167	4,588.80	DSP BlackRock Opportunities Fund	95	3,363.83
Indiabulls Bluechip Fund	165	419.17	SBI Magnum Multipier Fund	92	1,925.51
IDFC Focused Equity Fund - Reg	161	391.18	HSBC Equity Fund	92	640.96
Axis Equity Fund	159	1,847.99	ICICI Prudential Top 100 Fund	90	2,630.94
Invesco India Dynamic Equity Fund	158	368.11	Canara Robeco Emerging Equities Fund - Reg	90	2,291.44
ICICI Prudential Indo Asia Equity Fund	158	173.67	Aditya Birla Sun Life Top 100 Fund	90	3,335.67
Edelweiss Mid and Small Cap Fund - Reg	158	473.05	HSBC Dynamic Fund	90	46.32
Peerless Midcap Fund - Reg	157	88.09	Sundaram Select Focus Fund - Reg	89	497.73
Baroda Pioneer Growth Fund	147	540.84	BNP Paribas Long Term Equity Fund	89	580.29
Peerless Long Term Advantage Fund - Reg	147	35.98	IDFC Equity Fund - Reg	89	280.30
ICICI Prudential Focused Bluechip Equity Fund	146	14,336.63	DSP BlackRock Tax Saver Fund	89	1,137.88
DHFL Pramerica Long Term Equity Fund - Reg	146	147.74	ICICI India Top 100 Equity Fund	89	456.05

Data as on 31 August 2017.
List contains all equity-oriented funds except sector and thematic funds.
Passively managed funds and closed-end funds are excluded.
Source: Value Research

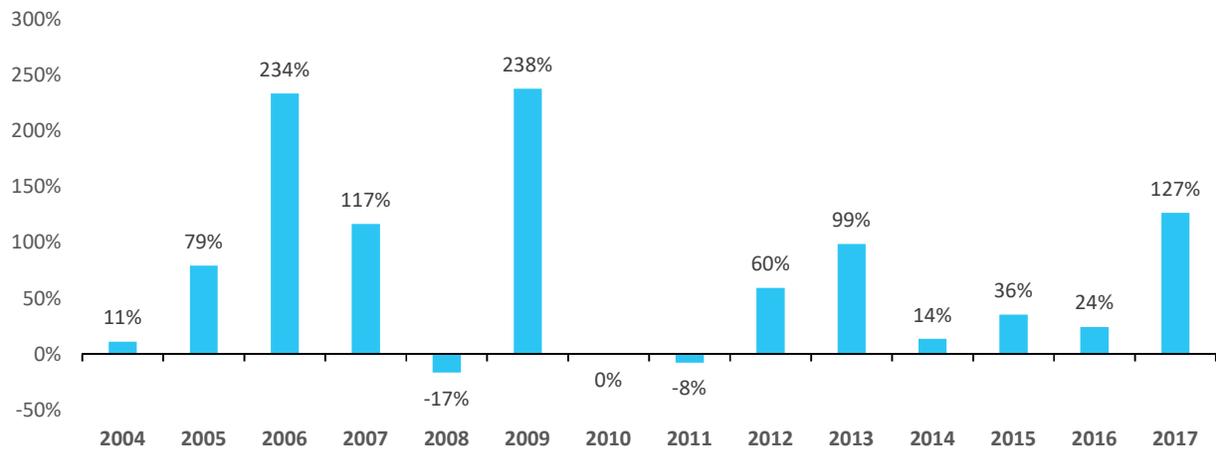
Look out for value-added mutual fund data in this space once a week, such as turnover ratio, cash holding levels of funds, concentration ratio, expense ratio and market capitalisation.

Source: Value Research, as reported by www.livemint.com

We have so far not even touched upon the macro-economic environment. It is important to appreciate here that an investor holding Tencent shares till date would also have had to weather the macro-economic gyrations in China and across the globe. Remember the ripples created by the global credit crisis (GCC), or the possibilities of a Chinese hard landing in the aftermath of the GCC, or the credit/banking crisis, or the housing bubble?

Imagine that you are sitting on a 14.5x return on your investment at the end of 2007 when you hear the news of the global crisis. You decide to shift your equity allocation (including your holdings in Tencent shares) to cash as you expect markets to crack significantly. Indeed, the year 2008 sees global risk assets tumble off the cliff. Your happiness, however, is short-lived as next year i.e. in 2009, the stock price multiplies nearly 2.5x. Somewhere along the way, you realise your mistake, and decide to buy into the rise. Your returns for the next two years are: 0% and -8%, even as the rest of the market continues to do well. Imagine the pain of sitting through that period.

Figure 9: Annual price changes of Tencent Holdings



Source: Yahoo Finance, Tamohara | Data for 2004 is from listing in June to year end, while data for 2017 is until November 21, 2017.

To summarise, historical returns are free from the distractions of share price volatility, business cyclicality, macro-economic instability, and psychological fallacies. The benefit of hindsight distorts the agony of 'holding on' by smoothing out volatility. In his September 2015 memo ([It's Not Easy](#)), famed investor Howard Marks of Oaktree Capital recollects a conversation with the legendary Charlie Munger, where the latter tells him the following about investing: *"It's not supposed to be easy. Anyone who finds it easy is stupid."* Nothing could have better surmised the idea, but for Warren Buffet's quote: *"Investing is simple, but not easy."*

Investing is simple because the underlying principles of analysing businesses on high quality, long term thinking, cash flow over reported earnings, management integrity etc. have survived the test of time. On the other hand, it is not easy as it demands a consistently disciplined behaviour on the part of the investor. Ignoring volatility, avoiding timing, focusing on the long term, and betting against the crowd are not traits that come naturally to us. For instance, contrarianism, as we had highlighted in ['The Fallacies of Our Mind'](#), is as painful as having an arm broken. Successful long term investing thus requires the investor to endure.

"Endure, Master Wayne. Take it. They'll hate you for it, but that's the point of Batman, he can be the outcast. He can make the choice that no one else can make, the right choice."

- Alfred J Pennyworth in *The Dark Knight*

Until next month,
On behalf of Team Tamohara,
Tejas Gutka

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