Playing With the Big Boys

I am often told that the game of stockmarket is rigged against the small investor. The big boys in the game i.e., institutional investors, enjoy major advantages which are not available to the small investor. Advantages such as access to timely information, research, and control over large sums of money.

There is just one problem with this theory: it is dead wrong. Most of the big boys' investment performance is in the public domain. If you study it, you will find that in-spite of all the above advantages, they haven't done very well. In fact, they have done quite miserably. Just look at the performance of GDR issues which were bought by institutional investors. Most of them are down by more than 70 percent from their offer prices a few years ago. Or, look at the long-term investment results of virtually all Indian mutual funds, both in absolute, as well as relative terms. Or, remember the now memorable decision of UTI to buy a large chunk of Reliance shares at Rs 200 (price adjusted for subsequent bonus) in 1994. That "investment" has produced a return of minus 40 percent in four years. Or, remember Morgan Stanley Growth Fund's great investment acumen, which has resulted in its investors losing 40 percent of their money in five years. There are plenty of other examples, all of which would make one ask, what were these guys *doing*?

They were playing the game of "passing the parcel" with stocks. The objective of this game is to pass the parcel to the next person before the music stops. Play it long enough and you will find that eventually the parcel ends up in your lap when the music stops.

Or, to change the metaphor slightly, as J.M. Keynes wrote *"professional investment may be likened to those newspaper competitions in which the competitors have to pick out the six prettiest faces from a hundred photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preferences of the competitors as a whole; so that each competition has to pick, not those faces which he himself finds prettiest, but those which he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view. It is not a case of choosing those which, to the best of one's judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. . ."*

Most institutional investors behave exactly the way Keynes described. They spend more time focusing on what other money managers are doing instead of focusing on what businesses are doing. It doesn't matter what stock they buy, so long as others are also buying it. And, if others suddenly decide to sell, they must sell too, lest they are left holding it when the music stops.

One recent example: In early December, when the stock price of Nalco was quoting at around Rs 18 per share, I had a long chat with Salil, my stock broker, about the attractiveness of this stock at that price. Salil had earlier sent me the annual report of the company which I had studied. He was quite bullish on Nalco and had been buying it at that price for several of his clients. One interesting fact that came up during our conversation was that all the deliveries that he had been receiving over the previous few weeks were coming from a single FII.

After studying the report and talking to Salil, I came to the conclusion that I would be willing buy shares in this company at less than Rs 16 per share. A few days later, on 14 December, I was in the middle of a class (I teach finance to MBA students) when Salil called me on my cell phone to inform me that Nalco was now available at Rs 15.60. I told him to buy me 10,000 shares on behalf of one of my clients. My cost after paying the brokerage came to Rs 15.75 per share. The stock had declined from Rs 18 to Rs 15.60 in less than a week. It appeared to me that the FII who was selling had told his broker to sell as quickly as possible. When any large investor tells his broker to sell large quantities of stock as quickly as possible, then unless the stock is highly liquid, the price will decline quickly to absorb the quantity being offered. I have no way of knowing for sure, but my guess is that this is

precisely what had happened in this case. Anyway, my client now owned 10,000 shares of Nalco at what I considered to be a bargain price.

Early this morning (i.e. on 28th December), I read the news that Nalco was one of the companies which was going to buy back its own shares. Needless to say, I was delighted. When a company buys back its own shares at a bargain price and then cancels the shares bought back, it automatically increases the value of the remaining shares outstanding.

Anyway, during the day Nalco's stock price rose to Rs 19.50 per share. I called Salil and asked him to liquidate this position which he promptly did at an average price, net of commissions, of Rs 19.12 per share. The total profits came to Rs 33,700. The return on investment came to 21.39 percent. Not bad for a 15-day holding period. I was happy, my client was happy, and my broker was happy. Needless to say, there was a good element of luck in this investment operation. However, I have seen the same story play itself over and over again. Some FII, or a group of FIIs suddenly decide that they want to get out of a stock as quickly as possible and as a result the stock crashes for no particular reason which has anything to do with the underlying fundamentals of the company. If it was MTNL in June 1998, it was EIH in September 1998, and Colgate in November 1998.

For me the lesson is simple: If I have properly studied the facts, and have decided to buy a company's shares, then if all deliveries are coming from FIIs, it is a good sign, not bad one.

Note

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