Sankaran Naren
ED & CIO
ICICI Prudential Asset Management Company

CHAPTER 1
A PASSION, NOT A CAREER

Not only did Sankaran Naren and his father start watching cricket together but they also learnt how to watch the stock market charts together. Living in a 2 member household from the ripe young age of fourteen, Naren developed hobbies along with and similar to his father - watching the stock tickers in the pink papers. This was his introduction to the world of finance.

The father-son duo used to make money out of smartly investing in Initial Public Offerings (IPOs) and marqee companies that were well established in their business. It was his father's belief that only if one invests in good quality companies, will he make money out of them. The father-son duo had a simple routine at that time - they applied for IPOs and sold the allotment. Naren would look for IPOs which had a good product base and consumer demand. He never looked at the metrics of Earnings per Share (EPS) or Price to Earnings ratio (PE ratio) before investing. This routine of regularly applying for IPOs and conducting post-mortems of which IPOs did well and which didn't instilled in Naren a deep interest for the finer basics of the stock market machinery.

Naren, after bagging good marks at higher secondary school, wanted to keep himself busy. He figured that in Grade 11 and 12, there wasn't much to do if he were to choose the commerce stream. Hence, he decided to follow his father's advice and went on to attain an engineering degree from the Indian Institute of Technology (IIT).

At IIT, Naren came to soon realise that there were others who were equal or more intelligent than him. It grounded him: a quality imbibed in his character to this day.To this date, “humble”, “grounded”, “down to earth” are the phrases which are used by Naren's peers to describe him.

Before pursuing his post-graduation degree at the Indian Institute of Management (IIM Kolkata), Naren barely understood much in the financial world. Although he was an engineer by degree, through his initial exposure to the markets, Naren still possessed a passion for the stock markets It was this thirst to learn more that led him to specialise in finance with

“At IIT, Naren came to soon realise that there were others who were equal or more intelligent than him. It grounded him: a quality imbibed in his character to this day. To this date, “humble”, “grounded”, “down to earth” are the phrases which are used by Naren's peers to describe him.”

his management degree. In those two years he learnt all about the world of finance - from reading annual reports to analysing stock ratios and prices.

On completing his post-graduation, in the late 80s, Naren took up a job at Industrial Credit and Investment Corporation of India (ICICI). Here, he

was placed in the project appraisal division, which, in a way, was a substitute for equity research in the late 80s.

During this period he continued investing with his father. He had even convinced his father to move from the primary market to the secondary market.

At a young age itself, Naren was not afraid to take up risk: he minimized the debt component in his portfolio and was fully invested into equities. **He even sold a part of his real estate to invest in equities as he had the conviction that equities would be the most successful asset class in the long term.**

Naren with his father

CHAPTER 2
BIRTH OF A VALUE SEEKER

Being a 100% bottom-up stock picker Naren started exploring the world of value investing. Naren was naturally inclined to the low Price-to-Earnings-Ratio (PE) investor from the beginning of his career. Justifying his choice of style, Naren notes that in those days (the 80s) the only investing books available were those written on Warren Buffet or by Benjamin

Graham – the founding fathers of value investing. Therefore, by default, value investing was the only style he learnt at that time.

This was in complete contradiction to his father's investing style. Naren's investments were based on the information edge that was gained by scrutinizing company annual reports. Naren naturally understood the rigours of quality analysis, and put into practice filters on price-earnings and intrinsic value, and he worked out the worth of companies based on future earnings.

Naren's father invested looking into the quality aspects. Naren dug into the value aspects, quite the opposite of his father. And in many ways, his urge to do better than his father was the driving force behind him being the value investor that he is today.

The bull run of '89 to '94 was the sweetest period for any value investor. The markets were very low on price, there was no equity cult in India and market inefficiencies were very high. Naren invested in many small-cap stocks. In the 90s, stocks were trading at price-to-earnings multiples of 1x, 2x and 3x. Some stocks were even trading below earnings. And it was an easy time to make money. One such example of his early investments was Lakshmi Machine Works (LMW). At that time its PE was 2x and its price-to-cash-earnings ratio was 1x, and the company had a four-year order book. This undoubtedly was an undervalued stock. Back in those days, there was a Madras Stock Exchange and he went to meet one of the stock-brokers to ask their view on LMW. The stock-broker cautioned him with an illogical arguement, saying that no one ever made money in any Coimbatore-based company. Paradoxically, between 1989 and 1994, the LMW stock went up 30 times.

> **"And in many ways, his urge to do better than his father was the driving force behind him being the value investor that he is today"**

Naren's father eventually saw the merit in Naren's stock and analytical ways, and eventually agreed with the new technique.

CHAPTER 3
STEADY LEARNER

Naren had just taken part in the incredible rally of '89 to '94. Having spotted many multi-baggers in previous years, Naren was "drunk with success" in his words, and was under the impression that he knew the stock market well.

Obviously, like many others in the market, he did not anticipate the impending fall of 1996. The thirty bagger stocks prior in the portfolio had him addicted, which led to mistakes in 1996. This did not position the portfolio well for the ensuing bear market of 1996. Naren did not realise at that time that the events between '89 and '94 were a one-time event.

> **"The thirty bagger stocks prior in the portfolio had him addicted, which led to mistakes in 1996"**

The period between '94-'96 tested Naren's stock allocation skills severely. Despite trying several techniques, the portfolio didn't really take off.

In one of his analysis, when the rates of interest hovered around 15% and the tax rate around 40% Naren looked at all companies raising equity and re-worked the savings the company would make on interest costs due to the funds raised.

Naren took those companies' previous year's profits, took into account, the savings and the interest due on the moneys collected, applied the tax rate and came to a revised profit. He then proceeded to make his calls based on this figure. But none of this worked.

Naren realised that companies which had raised money had shown profits that were higher than their actual earnings. After they raised the money through equity, the original bad figures came to light. Those were difficult times and an inefficient market coupled with dodgy numbers tried Naren's ability.

"To evolve as an investor, one needs to see a good up-and-down cycle. Cycles help in grounding you"

Looking back, Naren feels that he was super confident and under experienced in those days. In his words, "I was super confident and less experienced. I had forgotten the humility of my IIT days."

Despite the downbeat performance of the portfolio, Naren learnt much from the mistakes he made. Prior to the bust, he hadn't realised the risk from leverage, nor had he understood the concept of reversion to the mean. He realised that he didn't recognise cycles pre-'95.

"When there is a bubble or a bust, you need some kind of social support of like-minded friends - in a bubble for the guts to sell and in a bust for the guts to buy"

As Naren puts it, "To evolve as an investor, one needs to see a good up-and-down cycle. Cycles help in grounding you."

The trials of '94 saw Naren moving jobs. Naren left HSBC and joined a Chennai-based broking firm.

In 1996, Naren joined a small group of 7-8 people in Chennai who understood equities. It was a forum for all of them to share their mistakes and learn from each other's. With their wealth of experience, he began to understand the markets better. It helped him develop as an investor and prepared him for the future.

Naren believes that when one has made some serious investment mistake, having some mental and psychological support system is necessary. He found this support in friends who had made similar mistakes as he had.

"When there is a bubble or a bust, you need some kind of social support of like-minded friends - in a bubble for the guts to sell and in a bust for the guts to buy."

CHAPTER 4
GRADUATION IN BOTTOM-UP STOCK-PICKING

One may have often heard the phrase "Don't put all your eggs in one basket." In '97, Naren, learnt to do the exact opposite. In fact, before he made this shift in style, he was at the opposite end of the spectrum – he was an extremely diversified investor. Shyam, his friend from his Chennai group, taught Naren that this was not the way forward.

He and Naren together took a concentrated bet in a stock called TTK Prestige – an order for 500,000 shares. Those days, the shares came with transfer certificates, which meant that Naren had to fill 5,000 transfer forms.

That was the level of conviction. This was after pure bottom-up stock picking; both of them did their research and came to the conclusion that investment in this scrip was worthwhile. It worked very well for them.

Their next concentrated call, along with a few others, was buying a considerable percentage of the company MM Forgings from a mutual fund. Both these companies he says were unrecognised when they bought into them. This is where multi-baggers lie.

These were the two major investments that helped Naren build the confidence to take concentrated calls - something, which he now does regularly. He realised that to make concentrated returns, concentrated calls are necessary.

After joining his Chennai group, Naren realised the need to stand out from the rest. It was this mindset and the group's investment framework that helped him stay away from the dot-com bubble. This framework was meant to understand the investment cycle - phases of over-excitement and under-excitement.

Moving ahead to 1999, the tech boom was in its early stages, and investors were buying technology companies at absurd prices. "Are the prices too high?," Naren questioned, and worried why were people buying into all the new theories of valuations such as "eyeballs." Ultimately, it's cash flows that matter.

"In 2000, the market cap of Infosys was larger than the entire steel and cement sectors - in those days they were called "old economy companies."For Naren, market caps and trailing PE ratios are better indicators of a bubble"

The trailing PE ratios were absurdly high in '99. They were around 200x to 300x for IT companies. Naren observed that the sky-high market caps of those could not be justified.

In 2000, the market cap of Infosys was larger than the entire steel and cement sectors - in those days they were called "old economy companies. "For Naren, market caps and trailing PE ratios are better indicators of a bubble.

Naren and his group took the call in '98-'99 that they were approaching a bubble that would, at

some time, go bust. Convinced that the tech boom would burst at some time, he waited patiently for a reversion to the mean to work and stood behind his call with conviction.

Naren avoided high PE companies and saw 60x PE companies become 80x–150x their value. On the other hand, there were companies i.e. "old economy companies" that remained under-priced and relatively did not budge at all.

Naren avoided the IT sector, and instead focused on under-performing sectors such as cement and steel, which, by 2002, gave exceptionally good returns.

The days, saw Naren graduating as an investor by avoiding the fall, post-2000, which saw the IT stocks collapse. For Naren, controlling emotions, not being swayed by euphoria, and keeping market noise at bay are important investing skills.

This IT boom and bust serves as a testament for another cornerstone of Naren's investing philosophy - stand behind conviction calls without worrying about short-term performance.

From Chennai to Mumbai

Naren shifted to Mumbai, when the 2001 crash occurred, taking over as Vice President (VP) of HDFC Securities (operations). His boss soon realised his potential in equities, and asked him to head the equity research team. However, along with this new responsibility Naren was still expected to be VP of Operations.

By that time, people had lost faith in equities due to two successive falls. Sentiment was at an all-time low. Everyone around him told him to quit the equity markets. People suggested to Naren that his 12 years post his studies at IIT and IIM were a waste and that he should switch careers as stock markets were not paying off.

"This IT boom and bust serves as a testament for another cornerstone of Naren's investing philosophy - stand behind conviction calls without worrying about short-term performance'"

But Naren stuck to his guns; he refused to quit despite all this criticism. In fact this decision of not quitting is what he regards as one of his greatest successes. He saw that the market was dirt cheap. He advised his friends and clients to invest heavily in markets. He asked them to not keep a penny in traditional fixed-return instruments, to sell their house and invest in markets. But not many agreed with him.

Those who did greatly benefited from the rally that set in in 2003. It was one of the best rallies of the stock market in '03-'04. Naren later left HDFC Securities and led the Institutional Equities department of Refco.

All in all, for Naren the '94 to '03 bear market (except for IT stocks) really tested him as investor. "Having a long bear market is not easy at all. Long bear markets are very, very difficult to deal with," he puts it succinctly.

CHAPTER 5
THE CONTRARION MIND

After, coming to Mumbai at the age of 34, he had dreamt of being a fund manager. Finally in 2004, ICICI Prudential Mutual Fund hired him as a fund manager. Here he was given two funds to manage initially. Naren's fund manager role solidified his contrarian mind in '06-'07. In fact, he did not realise that he was a contra-investor until the market started labelling him as that. This style of investing and stock selection were as a result of his inherent value seeking nature.

Naren's fund did very well and at one time, Naren handled 80% of the ICICI Pru AMC's Equity AUM under his funds. When one handles such massive volumes of money, one cannot control or determine when money will enter the fund or when it would leave. For example, when there was euphoria in the market, money used to pour into the funds; this caused markets to be overpriced and expensive. Conversely, when there was fear in the market, funds would experience redemption; this caused the markets to be under-priced and cheap.

This basic problem of people investing when the market is expensive and selling when the market is cheap led to the birth of 'Contra Naren'. He was forced to act in a contrarian manner in order to deploy large volumes of money and generate returns too. He had to search for value deals. This was possible only if he bought what someone else wanted to sell; thereby, getting it at an inexpensive price.

Seeking contra-investments overseas

In 2012, Naren invested in a number of international schemes of mutual funds (schemes investing in markets abroad). The rationale for this was that the Indian markets were expensive and international stocks in general were cheap.

Naren viewed that after '08 there was a wrong notion created in the world that only emerging markets were good investments. As large amounts of money came into India though foreign investors, who took out money from their own markets. As a result, the Indian markets turned expensive and foreign markets cheap.

Naren saw that in the US there were stocks which had extremely good consumer names and were giving 4% dividend yields, while the local interest rates were close to 0%. Despite this, people in these markets were putting their money in deposits rather than the markets. This was because the western markets had become very cheap after '08: investors had become pessimistic. When foreigners were investing in Indian markets, Naren was probably the only fund manager who invested in foreign markets.

Being a natural contrarian, Naren found metals compellingly inexpensive in 2015. He noted that the entire metals sector was available less than a pharma company, and noted to journalists later that a country the size of India cannot just consume drugs, metals will be consumed as well. The call has been spot on, and since then metal stocks have skyrocketed.

FIIs were the most important block of Indian markets: and in '07-14, there investments would influence the market levels and movements. When FIIs turned negative or faced redemptions markets would correct rapidly. Nothing would have changed at the

ground level in india but market would correct by 10%. Naren used contrarian techniques in-built in funds such as that in the Balanced Advantage Fund. Naren bought when foreign investors sold.

That is not the case now. The same logic that worked then, does not work now because Indian funds inflow are very big relative to FIIs: there are periods when FIIs sell but the market still doesn't fall. One has to be alert with your own thumb rules created and keep changing with change in facts

Spreading the joys of contrarian investing

Naren has enrolled many new investors into thinking contra. Naren has made his own doctor a strong contrarian investor. Naren's doctor often pings Naren. In one such instance, his doctor pinged: "pharma sector is in trouble now and hasn't been performing. Should I buy a pharma fund?"

Naren has been an avid investor of his own money in the past seven-eight years in his own mutual funds, particularly dynamic asset allocation funds. He still applies the same contrarian model to decide which sector and scheme to invest in.

"If you have a discount sale in Westside, you buy clothes, in Big Bazaar you buy books; now you have a discount sale in equities and none of you are buying." Naren was often heard saying this publicly after the '08 bust.

CHAPTER 6
DODGING THE 2008 BULLET

Naren dealt with the bust of '08 much better than the previous two of 1995 and 2000. Based on the fact that when he deals with the younger generation they find it difficult to picture how a down cycle will set in after a long prevailing up cycle, Naren notes that until one has seen a bear market one won't be able to imagine how it will come or will find it hard to believe that something like that even exists.

> **"As soon as two parameters, the market cap and the trailing PE ratio, become absurd, the cycle tends to stall, and even turn"**

In fact, to Naren it was obvious that the market would fall soon after the '07 bull-run.
In India there are two categories or big companies – cyclical or brand. There are no big disruptive Tesla, Google-type companies; there is less of innovation and concept stocks. Therefore, cycles work much easily in this type of environment.

As soon as two parameters, the market cap and the trailing PE ratio, become absurd, the cycle tends to stall, and even turn. This happened in '08. Naren couldn't communicate this to his colleagues back in those days about the impending crisis which he attributes to the lack of top-down thinking models.

Naren believes that relative to '94, he was much more comfortable in '01 and '08 because he recognised the concepts of cycles and reversion to the mean.

These concepts formed some of his most important learnings from the books of

investment gurus such as James Montier, Michael Mauboussin and Howard Marks.

Although having a huge cash balance is generally interpreted as either being scared or out of ideas in the investment world, Naren has never refrained from doing so. In 2010, he had almost 35% of his portfolio as cash when the market PE levels were too high at 23 times for the Sensex, while in December 2011 he had just 5-6% in cash, when PE levels were steadier at 17 times. This clearly shows the confidence with which he allocates his assets swiftly.

His frank and straightforward asset-allocation calls are keenly reviewed and followed by investors across the country.

Every month Naren holds a webinar session in which thousands of distributors join in to listen to his views on the markets, the macros and asset allocation. Naren describes the pay-off as getting an immense satisfaction when he imparts the education. He loves his job as a

> **"Naren believes that relative to '94, he was much more comfortable in '01 and '08 because he recognised the concepts of cycles and reversion to the mean"**

fund manager and Chief Investment Officer of a big brand like ICICI Prudential as this job helps him influence life in more than 300 towns across India.

CHAPTER 7
THE ART OF SECOND-LEVEL THINKING

After reading books by famous American investor, Howard Marks, Naren began to appreciate the concept of second-level thinking.

Howard Marks has the best explanation of the concept. Investment decisions depend on various factors, including market sentiment, price and interest rates to name a few. The first level thinking involves making a judgement on impact of such factors on the share price.

Typically, the first level thinking tends to involve making simplistic estimation of the potential impact of various variables.

However, under most circumstances, such correspondence between variables does not exist in isolation and may have a significant interplay with the environment in which the interaction is taking place, motivations of market participants and timeframe over which the impact may be manifest.

First level thinkers are always ignorant of the very existence of second level thinking and the need to pursue it. This is exactly what the second level thinking tries to address.

Naren was instrumental in the launch of a value series in the quarter ending December 2013. At that time, conventional wisdom (plain first level thinking) pointed to avoiding investments in equities considering worsening macro-economic indicators such as a high degree of volatility in the foreign-exchange rate, a high Current Account Deficit (CAD), the likelihood of

political uncertainty considering the then coming parliamentary elections.

This was amply evident in subdued valuations of many quality stocks. Naren, however, saw this as an opportunity as his second-level analysis indicated that the steps undertaken by the RBI were proving to be successful and that the volatility in the exchange rate and the resultant pressure on CAD were likely to subside. The call proved to be a tremendous success, with investors registering substantial gains.

During the winter of 2015, global commodity prices nose-dived. The primary reason for this was over-supply globally in many commodities. Share prices of many Indian metal manufacturers registered a substantial fall. Based on first-level thinking, one would have been prompted to sell these stocks.

On second-level thinking, however, Naren could see the scenario in which domestic demand for such metals was unlikely to subside as, even considering the replacement capital expenditure, there was sufficient domestic demand.

Further, even if one adjusted for reduction in imported prices of metals (dumping by companies operating in countries with a higher supply situation in the absence of a safeguarding duty), many domestic companies had a highly-efficient cost-structure, resulting in cost of manufacturing being competitive even considering the landed price of imports. Naren, therefore, continued to hold such investments, which bounced back by mid-2016. To sum up, second level thinking is more profound in terms of assessing the impact of market factors. It plays a key role in achieving market-beating performances over a longer term. **Apart from experience, a second-level thinker has to inculcate the habit of thinking probabilistically- through developing a range of future scenarios, attributing the probability of them materialising, and assessing the impact of potential outcomes on the share price.**

CHAPTER 8

BELIEF IN REVERSION TO MEAN

Naren completely concurs with Howard Marks' view on reversion to the mean theory; this is the underlying reason behind cycles. According to Naren, Howard Marks explains this concept beautifully with the help of the pendulum analogy: he says that just like the movement of the pendulum, people's emotions move from extreme fear to extreme greed.

The market over reacts in both positive and negative environments. In the case of a positive environment, the markets swing in one direction - greed overcomes rationality. Whereas in the case of a negative environment, the markets swing to the other extreme - fear overcomes rationality. This alternate movement of investors from the zone of greed to fear creates investment opportunities for the more mature investor, who understands the concept of cycles.

The opportunity in disguise

The common man doesn't seem to acknowledge the existence of cycles. In '12 and '13 the real estate cycle was extended. Naren

tried to explain to everyone that in this market the cycle had swung to the extreme side of greed but few listened to his advice and acted on it. In his opinion it is very important that one believes in cycles. Within these cycles lie buying opportunities. The investing mantra - "Buy on fear and Sell on greed" is born out of this concept.

"The market overreacts in both positive and negative environments. In the case of a positive environment, the markets swing in one direction - greed overcomes rationality. Whereas in the case of a negative environment, the markets swing to the other extreme - fear overcomes rationality"

Naren keeps a keen eye out for negative news on industries and companies, which would lead the market to overreact and cause an abnormal fall in their prices. This is an opportunity in disguise.

Another example of Naren deploying this mantra is when there is pessimism in the Western parts of the world, which leads to pessimism in the Indian markets. This is an opportunity Naren simply adores this because foreign investors offload good stocks at such global events through high-volume selling of ETFs. This again creates a money-making opportunity.

Naren has noticed that every time foreigners have sold in India, investors have made good returns over the next three years.

CHAPTER 9

LEARNING THE "CHECKLIST" METHOD

Every investor has their share of right calls and wrong calls. Naren is also greatly influenced by a book Dr. Atul Gawande - 'The Checklist Manifesto'. He expressed an interest in meeting Dr. Gawande to one journalist, and got the opportunity to interview Dr. Gawande. This made him more enthusiastic to follow the philosophy of checklists.

Dr. Gawande has explained beautifully how bizarre situations can be countered and broken down into a series of statements which brings more accuracy and precision to one's approach to the situation.

Giving the example of the airplane landing in the Hudson River, Dr. Gawande says that it was the thorough checklists followed by the pilots that allowed all 155 passengers to come out alive.

According to Naren, any investor, including himself, has repeated mistakes made in the past. To counter this, Naren falls back on the checklist system.

For example, he and his team noticed that they had made a number of errors in the 2009 elections in India. They obviously didn't want to

repeat those set of mistakes in the 2014 Indian general elections and, therefore, created a checklist as to what went wrong in 2009 and what needed to be changed in 2014.

After coming up with a checklist, they realised that in 2009 there was too much pessimism in the market.

To prevent this from becoming an issue in 2014 and to keep people invested for the long term, despite temporary pessimism, the company launched closed-end funds – a decision arising out of the checklist system.

In February 2017, after India's Annual Budget was released Naren had a call with all the distributors and advised them to invest all the money they had in the market. Naren had made checklist that determined the actions to take post the budget.

"Therefore, one should conduct a pre-mortem - this allows one to make swift decisions on the occurrence of an event, allowing one to be the first to act."

The condition was that if the Budget did not contain any negative news for the markets as a whole (such as capital gains tax), we were in for a boom. Naren's checklist framework helped in providing clarity to his thoughts and taking quick decisions on an event occurring.

If one wishes to increase investment in a particular sector, a decision could be based on a checklist. Potentially, the factors influencing such a decision could be:

1) Market-cap of the sector should be reasonable and non-inflated (rationale: the sector should be inexpensive and not in a bubble)

2) Mutual funds should be underweight in that sector (rationale: unnoticed stocks or sector; less interest means a lower price)

3) Entities present in the sector should be exiting and many companies should have suffered losses. (rationale: temporary flow of bad news causes markets to overreact, further reducing stock prices)

This checklist yielded a positive result for the telecoms sector and a negative result for the technology sector. The reason for the latter was that the tech sector did not fulfil one of the criteria. Its market cap was highly inflated, thus failing one of Naren's contrarian tests.

Do a pre-mortem

"A post-mortem is OK", but a 'pre'-mortem would be better. Naren is a great believer in doing a pre-mortem rather than a post-mortem.

Since approaching investing with the various options before you of what could potentially happen would reduce mistakes".

Therefore, one should conduct a pre-mortem - this allows one to make swift decisions on the occurrence of an event, allowing one to be the first to act.

CHAPTER 10
TOP-DOWN THINKER

Naren was a 100% bottom-up stock-picker until the 2008 crisis. "I didn't know something like top-down thinking existed," points out Naren.

In 2008 he realised that company side research and information does not answer all questions: there were wider issues affecting stock-markets.One of Naren's biggest challenges has been to change his investing style to incorporate top-down thinking.

An example of Naren's top-down, second-order level and contrarian thinking is seen in his Fixed Income call in 2012-13.

According to him, the Current Account Deficit had increased abnormally and was going to be cut, and so too national inflation. In such a scenario, he knew that interest rates had no option but to fall. The call proved to be correct and led to high returns in Fixed Income assets.

"In 2007, 2008 and 2009, I almost cried. In 2007 people invested stupidly, in 2008 people disinvested stupidly and in 2009 the market rally was phenomenal. People who should have made large sums of money actually ended up losing money because of this"

Still, at that time, some people were saying that the Reserve Bank of India was hawkish. In some ways, a clear top-down thinking in the market place has been lacking. According to him, it is this area that the common investor of India needs to improve the most.

Why dynamic asset allocation funds

From the top-down approach and contrarian thinking, Naren stepped into the method of dynamic asset-allocation - something which helps him help his investors deal with volatile times.

"In 2007, 2008 and 2009, I almost cried. In 2007 people invested stupidly, in 2008 people dis-invested stupidly and in 2009 the market rally was phenomenal. People who should have made large sums of money actually ended up losing money because of this."

This unfortunate sequence of events gave birth to the concept of dynamic asset-allocation in Naren's investing philosophy.

The ICICI Prudential AMC team created a model which bought into equity markets on the way down and sold on the way up. This was the best way to deal with retail customers.

The Balanced Advantage Fund of ICICI Prudential is based on this contrarian and dynamic-asset-allocation model. Naren believed in increasing equity holdings as markets slid and decreasing them when markets climbed.

CHAPTER 11
USE OF BEHAVIORAL FINANCE

According to Naren, there are three methods to create alpha:
(1) Information Edge
(2) Business Understanding Edge
(3) Behavioural Finance

The inclusion of Behavioural Finance in his decisions has taken different forms, including concepts such as markets overreacting to news.

Sometimes, without taking into account the behavioural aspect and only relying on the first two, one loses out on opportunities. For example, with the launch of Reliance Jio, investors thought that the sector's P&L would be destroyed.

Prices of the telecom and allied sectors dropped in anticipation of a tariff war. But for Naren, this was a clarion call. It signalled a buy call according to the concept of a reversion to the mean.

This call couldn't have been generated out of an information edge or a business understanding edge. In fact this Behavioural Finance is what makes Naren look for problems in the first place.

The next step is to investigate whether the problem is temporary or not. The challenge with this approach is that investors must have patience for at least two years to reap the benefits.

For Naren, investing is part science, part art. And it is as important to deal with the art side of it as it is to deal with the scientific aspect. Naren feels that investing is as much about the humans as it is about the stocks "Emotional Quotient is as important as Investment Quotient."

Every investor will have his or her stress points periodically. And in these stressful times, severe self-doubt sets in.

He believes that although self-doubt is a normal and continuous process it is important not to let that self-doubt cause changes in philosophy easily because "a constantly changing philosophy is no philosophy."

"Naren feels that investing is as much about the humans as it is about the stocks "Emotional Quotient is as important as Investment Quotient"

People read too much about a new investment philosophy and keep on changing that philosophy without properly implementing the previous one. "Even if you have the best investment philosophy, you will inevitably have hard and difficult periods - even Warren Buffet struggled in '98 and '99 but he still stuck to his principles."

CHAPTER 12
DOWN TO EARTH

Having joined ICICI Prudential AMC as a fund manager in 2004, Naren proved a stellar fund manager and gained respect not only in the company but in the industry too. He was soon offered the position of CIO in '11, which he happily accepted.

For any fund manager, the hardest decision is to pass on management of a fund which has been nurtured and built up by them to another individual. Naren has made these decisions and has given up managing quite a few funds he started his fund-management career with.

He has worked with the CEO and divided the assets under management of the company amongst various fund managers based on investing style, calibre and philosophy.

"the worst market for Naren are during periods of bubble and the best would be from bust to boom or boom to bust"

Following great investment discipline, this has ensured that the AUM of the company is not concentrated with a single fund manager.

Naren redefined his role as being that of an asset allocator. He likes to be called a fund manager of assets, not of stocks.

As someone who started off his investing career strongly countering his father's quality style of investing, Naren also has a grip on the fact that this inherent value mindset (which emerged from Benjamin Graham's books) could potentially be his weakness. Unlike his father, even today Naren finds it difficult to pick up quality companies by paying a bit more for them.

He has consciously made his own job difficult by constantly looking for value in the market. He believes that in the last five years or so quality stocks have fared well and since that isn't his core competency he has had a slight difficulty in matching the performance of the markets.

In this context the worst market for Naren are during periods of bubble and the best would be from bust to boom or boom to bust.

CHAPTER 13
30 YEARS OF PASSION

The stock market is Naren's passion. He, to this date, watches stock price movements like a watchdog, and admits that it is the most unprofitable task, yet he cannot stop himself. Naren starts his day at 8 and works till 7 but believes a fund manager's job cannot be restricted to work timings. A fund manager should be very passionate about his profession, considering he is managing public money. Naren himself conducts zero-based thinking every weekend. Every Monday morning he enters office with a bunch of ideas that he has

already performed a 'pre'-mortem analysis on.

At office, his time is spread over many things, which include his daily tasks as a CIO coupled with tracking schemes, meeting analysts from various broking houses, and reading. He is a person who loves to read anything and everything. The level of information which is available today is much more than the amount of time you have to read it.

He reads at least a dozen newspaper, goes on to the NSE and BSE regularly to skim for news and reads through annual reports of various companies like a breeze. He is a person who would even read the paper in which one sells bhelpuri!.

He is known as a 'Contrarian with a good understanding of value' and, like all contrarians, he has openly admitted to all the challenges he was faced with throughout his journey of investing. He took them one lesson at a time and they helped him become the fund manager he is today.

But it is his simplicity and sincerity that has gained him much respect among his peers and colleagues in the investment world. He is known to be a very determined person, who does not shy away from taking risky positions, a man who is strong-headed and has complete convictions on his opinions and calls.

But, he still claims not to understand the market completely. He is humble enough to stick to reality. His mantra lies in Warren Buffet's words: "You have to be emotionally well-balanced to make money in financial markets."

The three hour conversation left me in complete awe of this simple man as he patiently explained his various theories in very simple English. A brilliant top down and second level thinker who has always followed value investing and behavior finance. A firm believer in cycles, has taken concentrated contra calls, always ready to accept and learn from his mistakes by following the discipline of check list and parameters.

TIMELESS LESSONS FROM THE "GURUS"

S. Naren has imbibed invaluable lessons from his "gurus." Over the many years ago when starting of investing, Naren found that information was difficult to find. But after reading tomes of notes and research and books, Naren identified his four "gurus" from whom he learnt a lot about investing in the market.

NAREN'S GURUS

James Montier
"One of the most useful things I have learnt over the years is to remember that if you don't know what is going to happen, don't structure your portfolio as though you do."
James Montier is a value investor and the author of many books including the Little Book of Behavioral Investing. James is currently the author of GMO's European Asset Allocation Team, a private global investment management firm.

Howard Marks
"In the world of investing, being correct about something isn't at all synonymous with being proved correct the right way."
Howard Marks is an investor and a prolific writer. His memos to clients at Oaktree Capital, which he founded in 1995, is widely read by the investment community.

Michael Mauboussin
"In investing, there are many ways to fail, but there are many ways to succeed too. The key is to have your process in line with your trading behavior."

Michael Mauboussin has written several books. He is now the managing director and head of Global Financial Strategies at Credit Suisse.

Dr. Atul Gawande
Dr. Atul Gawande is a surgeon. He has written The Checklist Manifesto, which talks about making thorough checklists in medicine and in other fields.

WHAT NAREN LEARNT FROM THE GURUS

The two key lessons Naren learnt from the gurus is
1) Practice Asset Allocation
2) Keep valuation in mind

One who follows asset allocation would have invested in equity in 2002-03, while divesting in 2007; or invested in gold in 2007; or invested very aggressively in equities in 2008-09; or invested in international funds before August 2013; or invest in gilt or income funds in 2014 till September 2014, among others.

With asset allocation, one views the prices of various asset classes with a bird's eye-view, hence is able to keep a holistic view on various asset classes simply by following the simple asset allocation.

HOW TO PRACTICE ASSET ALLOCATION

- Create a checklist of what works and what doesn't work for you
- Be unconstrained
- Have the guts to invest in underperforming asset classes
- One has to believe in reversion to mean
- Be a contrarion, but use judgement, healthy dose of scepticism, and a calculator
- Luck determines success in the short-term, but skill determines long term success
- Invest top down and bottom up