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# The Low Hanging Fruits of Sensible Investing- *Anshul Khare*

In 2018, over eight lakh people died of cancer in India. Disturbing but not shocking. What's shocking is that if you visit the Tata Memorial cancer hospital, you will find the longest queue in the lung cancer department. Numbers attest to this observation. According to figures published on Cancerindia.org.in, close to 40 % of all cancer deaths were accounted for by tobacco use (smoked and smokeless).

The reason I call this statistic shocking is because 90 % of lung cancer cases are preventable. The biggest impact solution in cancer research isn't about finding a cure for the disease but discovering a method that can convince people to quit smoking.

Quitting smoking (both active and passive) is the low hanging (and most impactful) fruit to be plucked in the fight against cancer. Yet not enough resources are being deployed in that direction. Why? Because the idea of winning a war against a disease using something so simple — prevention — is boring. Robert Weinberg, and MIT cancer researcher, explains why:

*"[Prevention is] sometimes overlooked because it's intellectually not very stimulating and exciting. Persuading somebody to quit smoking has nothing to do with molecules and genes and cells, so people like me are essentially uninterested in it, in spite of the fact that stopping people from smoking will have vastly more effect on cancer mortality than anything I could hope to do in my own lifetime."*

Atul Gawande, a renowned surgeon and author, recounts the case study where a group of medical researchers brought down the incidences of diarrhea by 52%, pneumonia by 48%, and skin infections by 35% among kids in a slum in Pakistan just by using one simple solution — teaching the parents the importance of washing hands multiple times during the day. And not just for slum children, for everyone, washing hands is the lowest hanging fruit (with maximum return on investment) for keeping healthy and living a longer life.

Another one — in the US, about 51 % of deaths in road accidents are caused by not wearing seat belts.

My point is that this idea — the maximum return coming from simple and boring solutions — keeps surfacing in almost every field where you care to dig deeper. And the unmistakable pattern you'd find in people's behaviour in all these fields is that they miss these obvious, simple, and boring things and run after the complicated.

Morgan Housel writes —

*"The smartest minds and the biggest incentives in medicine should be focused getting people to eat better, exercise more, and quit smoking, because that makes the biggest difference in outcomes. But it rarely works that way. There is a bias toward excitement over sheer importance for both individuals and the professionals who help them. This is understandable: Helpers want an interesting career, and clients want advice on stuff that isn't obvious to justify the cost. The result is that the obvious but important stuff is discounted and ignored to favor more exciting projects."*

So that brings us to the most important question for investors — is it possible that in investing also there are a few simple things that can make a substantial impact on long term investment returns? In other words, what are the low hanging fruits of sensible investing?

Ideally, the smartest brains and the biggest incentives in finance should be trying to get people to save more money, argues Housel, "because that makes the biggest difference in outcomes."

Apart from saving money, there are a few more things on my list which I think have an outsized (but unnoticeable) impact on how wealth compounds for most investors.

1. Avoiding debt
2. Turning off the noise
3. Not interrupting the compounding

Notice the pattern? It's not about what should be done. It's about what should not be done. In investing, maximum bang for the buck comes from subtractive activities.

Debt is like a dagger mounted on the steering wheel. It adds to your stress and it's hard to avoid getting hurt when your car hits a patchy bump. Not to mention, a sudden jolt (akin to a financial crisis) and the dagger can take you out of the game.

The noise from the financial media (including unsolicited financial advice coming from friends and neighbours unqualified to opine on investing matters) takes your attention towards things that are unimportant over the long term. Things like investing strategies for minimizing taxes, exploiting new policies in the budget, optimizing for interest rates and other macroeconomic. For someone paying 18-24% on his debt, it's plain foolishness to worry about extracting an extra 2% investing returns by dancing in and out of the markets based on latest investing fads.

Not interrupting the compounding is in a way related to the previous point. When you ward off all the noise, you have one less reason to sell your long term winners. It's not easy to find businesses that are on a trajectory to continue improving the earnings at a high return on capital for a long time. Once you find such wealth creators, don't be a fair-weather friend to them.

I know someone who diligently clocks 5 km every morning and after the walk rewards himself with a cup of sugary tea and a cigarette. Do you know someone who refuses to wear the seat belt but has paid more for a fancy car with 5-star rating in a crash test?

Now you know why a large part of sensible investing is easy to overlook. Because it's deceptively simple.

Once you've taken care of the low hanging fruits of investing — saving money, avoiding debt, turning off noise, and not interrupting compounding — you can rest assured that 90 % of your job is done.

## MARKET COMMENTARY AND SSIAS PERFORMANCE

Speaking of low-hanging fruits, the government of India announced some major incentives for the corporate sector.

While there were many announcements, we lay down below the main points for our discussion:

- Slashing basic corporate rate tax from 30% to 22% for domestic companies that don't avail any exemption/incentive.
- Reducing the effective tax rate for these companies to 25.17% inclusive of surcharge and cess. Also, such companies shall not be required to pay Minimum Alternate Tax or MAT.
- Slashing corporate tax rate from 25% to 15%, for domestic companies incorporated on or after 1st October 2019 making fresh investment in manufacturing to boost manufacturing and the 'Make-in-India' initiative, the government has slashed.
- Making available the option to pay income tax at the rate of 15% to companies which do not avail any exemption/incentive and commence their production on or before 31st March, 2023.

Social media was flooded with mostly positive commentary on this news. While we welcome the positive news on tax-cut, our optimism is tempered to some extent. Because we believe that as investors, our focus should be on the long term sustainability of a business or industry. Here it is relevant to reproduce below an excerpt from the goldmine of investment- "The Warren Buffett Letters to Shareholders."

For example, when the franchise is strong and after-tax profits are regulated in a relatively precise manner, as is the case with electric utilities, changes in corporate tax rates are largely reflected in prices, not in profits. When taxes are cut, prices will usually be reduced in short order. When taxes are increased, prices will rise, though often not as promptly.

A similar result occurs in a second arena - in the price-competitive industry, whose companies typically operate with very weak business franchises. In such industries, the free market "regulates" after-tax profits in a delayed and irregular, but generally effective, manner. The marketplace, in effect, performs much the same function in dealing with the price-competitive industry as the Public Utilities Commission does in dealing with electric utilities. In these industries, therefore, tax changes eventually affect prices more than profits.

In the case of unregulated businesses blessed with strong franchises, however, it's a different story: the corporation and its shareholders are then the major beneficiaries of tax cuts. These companies benefit from a tax cut much as the electric company would if it lacked a regulator to force down prices.

Many of our businesses, both those we own in whole and in part, possess such franchises. Consequently, reductions in their taxes largely end up in our pockets rather than the pockets of our customers. While this may be impolitic to state, it is impossible to deny. If you are tempted to believe otherwise, think for a moment of the most able brain surgeon or lawyer in your area. Do you really expect the fees of this expert (the local "franchise-holder" in his or her specialty) to be reduced now that the top personal tax rate is being cut from 50% to 28%?

Your joy at our conclusion that lower rates benefit a number of our operating businesses and investees should be severely tempered, however, by another of our convictions: scheduled 1988 tax rates, both individual and corporate, seem totally unrealistic to us. These rates will very likely bestow a fiscal problem on Washington that will prove incompatible with price stability. We believe, therefore, that ultimately - within, say, five years - either higher tax rates or higher inflation rates are almost certain to materialize. And it would not surprise us to see both.

You may access the full report here: https://www.berkshirehathaway.com/letters/1986.html

While we do not believe that things in India would move exactly the way Buffett predicted it for the USA, the impact here should be somewhat similar.

Benjamin Franklin, the father of America, once said,
*"…but in this world nothing can be said to be certain, except death and taxes."*


**"Of course you have a purpose in life. You pay taxes, don't you?"**

Hence, **we feel that an investor is better off ignoring this whole news of tax-cut and focus on finding out best investible opportunities using bottom-up stock picking principles.** Not to say that tax-cut does not improve the sentiments of corporate India and revive the much needed animal-spirits.

It surely does. And it should do well for the economy and businesses in the long run.

Now, let's move on to SSIAS portfolio performance.

| PERFORMANCE OF SSS AS AGAINST MAJOR INDICES (from 01.08.2017) | | | | |
|---|---|---|---|---|
| **PARTICULARS** | **31.12.2017** | **31.12.2018** | **30.06.2019** | **30.09.2019** |
| Nifty 50 | 4.11% | 7.39% | 16.60% | 13.48% |
| S&P BSE Midcap | 15.29% | -0.21% | -4.20% | -8.69% |
| S&P BSE Smallcap | 19.63% | -8.41% | -11.33% | -18.05% |
| SSIAS Model Portfolio | 16.71% | 4.53% | -0.73% | -8.07% |

The last quarter clearly has been tough for us. Two of our most high conviction bets are facing temporary headwinds. Market is reacting to some near term problems in these companies which we believe would be solved in due course. We continue to back these companies as we still believe that their long term attractiveness of the businesses remains intact. Also, they are run by honest and able promoters who have a long track record of generating consistent wealth for the shareholders.

Legendary investor Howard Marks classifies investors into two types of thinkers.

First-level thinker & Second-level thinkers

First Level thinkers are reactive to news and information.

And Second level thinkers go deeper into it and take a longer term view.

In one of his memos to his clients, he says this:

*"First-level thinkers think the same way other first level thinkers do about the same things, and they generally reach the same conclusions. By definition, this can't be the route to superior results. All investors can't beat the market since, collectively, they are the market."*

*"Those who consider the investment process simple generally aren't aware of the need for—or even the existence of—second-level thinking. Thus, many people are misled into believing that everyone can be a successful investor. Not everyone can. But the good news is that the prevalence of first-level thinkers increases the returns available to second-level thinkers. To consistently achieve superior investment returns, you must be one of them."*

We do not claim that we, at SSS, are expert second-level thinkers, but we surely aspire to be one. Hence, we want to look at our portfolio keeping the principles of second level thinking in our minds.

In this age of social media, all kinds of news (both positive and negative) quickly find their place in our mobile phones. Hence, it becomes more and more difficult to continue backing our ideas with conviction. But we would try our best to look for the hard facts and evaluate accordingly.

And finally, we know that we can be wrong in our assessment, so we are fairly diversified at portfolio level.

If we could go back and change one thing, we would have liked to phase the allocation to our conviction bets. If we had lesser allocation in these stocks in the past, at this time we would have loved to buy more.

## SIGNING OFF

As we wrap up this edition, we would reiterate the point which Anshul mentions at the beginning.

"The Low Hanging Fruits of Sensible Investing"

And they are:

**Saving money**

**Avoiding debt**

**Turning off noise**

**and**

**Not interrupting compounding**

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