

Fund Managers Commentary

The Girik Multicap Growth Equity Strategy is inspired by the CANSLIM philosophy of stock picking developed by American investor William J. O’Neil. The goal of this strategy is to identify leading companies from leading industry groups that show sharp acceleration in earnings, newness in products or change in management and suggests buying them at the right price with enough margin of safety ahead of the company’s major stock price advance.

The markets took a little breather during the month, led by a fall in the markets across the world. Midcaps and small caps, however, posted net gains, outperforming the frontline indices, led by continued buying across sectors. The industry leadership continued to be dominated by Pharmaceuticals and APIs, chemicals, Agri related sectors, and online classifieds. IT sector jumped several notches to become one of the top leading sectors. The market has seen a swift change in leadership. Sectors that were leading before the March fall like financial services have fallen entirely by the wayside and the baton is taken over by sectors that were non-performers for a long time.

When such churn happens in the market, the first reaction is disbelief. Investors shrug it, criticize it, and refuse to acknowledge it. Such investors fear the unknown and are taken by surprise when newer, unheard names start making new all-time highs. After all, how can a sector suddenly spring to life without a clear indication and without the biggies knowing about it?

However, if one analyses the market with a big magnifying lens, it all becomes clear. Here’s what happens. The industry that leads in one bull market normally won’t come back to lead in the next, with some exceptions. Groups that emerge late in a bull market are sometimes the potential leaders of the next bull phase. However, an impending bear market takes them off radar temporarily and they come roaring back in the new bull market that follows. These groups then become the leaders of the next bull market, continuing their upward march led by accelerated earnings growth.

In the current uptrend, the industries that have led so far saw an initial bout of performance that went unnoticed before the crash. Investors were loaded on and blinded by the leaders of the past, which crumbled like a pack of cards in the crash. Crashing NAVs further kept the investors involved in praying for a recovery. In such times investors get so engrossed in the worry that they let new phenomenal opportunities slip by. By the time the course correction happens, at least half of the opportunity is gone. It’s a super-simplified but true agony.

In most bull markets, the new 5-6 major industry groups continue to lead unabated, and by the time the older industry groups join in, the party gets over. Studies show that 37% of a stock’s price movement is directly tied to the performance of the industry group the stock is in. Another 12% is due to strength in its overall sector (of which industry group is the subset). Therefore, roughly half of a stock’s move is driven by the strength of its respective group. That’s important because stocks in leading sectors end up getting premium valuations later in the move, which is hard to imagine at the beginning. That’s also because the fear of the unknown turns into the fear of missing out (FOMO), turning the very doubters into aggressive buyers.

In CANSLIM, we have simplified this process for ourselves. We leave our biases behind while looking at screeners. Even when we are invested in old leading industries, we get excited when new industry groups pop up on our screeners. Our screeners are designed to point the new leading industry groups early on. Surely, there are always risks and too many unanswered questions with the new leaders. But, we also understand that the biggest returns are made in uncertainty. By the time we will have answers to all the questions, the opportunity will be gone. The solution? We hop on the ship with limited cargo and continue looking for answers. The answers do come by and we keep adding based on how good those answers look. All this while, as a risk management practice, we stand ready to throw in the towel when we smell the ice. For the times when we have blocked noses, we abandon the titanic as soon as it hits the iceberg.