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Lessons from the coffee can

BOOK REVIEW

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These are bewildering times for Indian investors. There is widespread disenchantment with many of the traditional mainstays of investment. Real estate prices have refused to budge upward since 2013 and may not do so for a few years more. Many investors, especially in north India, have lost their lives' savings to unscrupulous builders and their half-completed residential projects. Gold has been dead as a dodo for half a decade. Until recently, fixed deposit rates, too, were declining. Against this backdrop, Saurabh Mukherjee — the chief executive officer of institutional equities at brokerage firm Ambit Capital and the author of two well-received books — and his co-authors make a persuasive case for investing in stocks.

The eponymous concept of coffee can investing is explained in the second chapter. The name is derived from the times when banks did not exist, and Americans stuffed their dollars in coffee cans and hid them in their mattresses. The essence of the idea is to select a portfolio of high-quality stocks and leave it untouched for a decade. Two filters have to be used for stock selection: Each company in the portfolio should have increased its revenue by at least 10 per cent annually and generated a return on capital employed (RoCE) of 15 per cent over the past decade. The investor should not make any alterations to the portfolio even if some stocks within it underperform. Both the back-testing done by Ambit and the live portfolios run by it for clients have demonstrated that the coffee can portfolio outperforms the Sensex by wide margins, while displaying much lower volatility.

A few years earlier, there was a lot of excitement among investors about acclaimed hedge fund manager Joel Greenblatt's *The Little Book that Beats the Market*. It described the so-called magic formula, which entails selecting stocks with high earnings yield (the inverse of price-to-earnings ratio) and RoCE, holding them for a year, and then selling them. The back testing for the magic formula was, however, done in the US market. One can't be sure how well that approach would work in India, unless you can do the back testing yourself. Mr Mukherjee, on the other hand, is offering you an approach that has been found to work in the Indian market.

For investors to implement the coffee can approach themselves may not, however, be easy. They would need access to a database to cull the stocks for this portfolio each year. A stocks database is an expensive proposition in India costing ₹100,000 a year or more. The alternative would be to subscribe to Ambit's portfolio management scheme, an option open only to investors with sizeable portfolios. Nonetheless, the fact that Mr Mukherjee and his co-authors have chosen to put this approach in the public domain is a positive development. Many enterprising do-it-yourself investors will find a way around the above-mentioned obstacle and benefit from it.

Besides discussing the coffee can portfolio, the book packs in a number of lessons that investors will find relevant to these times. In the chapter on expenses, the authors discuss the need for investors to maintain low portfolio churn and avoid high-cost products. He informs readers about the vanishing outperformance among large-cap funds and advises them to move from active funds to low-cost exchange-traded funds in this category. He also recommends direct mutual funds, whose expense ratios are much lower than that of regular funds. Use the money thus saved to hire a Securities and Exchange Board of India (Sebi)-registered investment advisor, who makes his livelihood out of the fee you pay him, and is hence likely to offer advice that is in your interest.

In the next chapter, the authors demonstrate how residential real estate has served investors poorly. The chapter "Small is beautiful" highlights the ability of small-cap stocks to outperform large-caps over the long run. But given their higher risk levels and the scantiness of information about them, investors should stick to seasoned fund managers for investing in small-caps.

Readers will also find the chapter titled "Pulling it together" valuable. It outlines a simple approach to portfolio construction that they can implement themselves for their long-term goals.

Altogether, this book will help investors find answers to their myriad dilemmas about investing. Many honest, diligent individuals approaching retirement are a disappointed lot today. Despite a lifetime of hard work, they find themselves falling far short of many of their cherished goals — a foreign education and a memorable wedding for the children, an annual holiday abroad, and an adequate corpus that will allow them to maintain the lifestyle to which they are accustomed after retirement. If you, too, belong to this category, turn to Mr Mukherjee's book. Read it, absorb its key lessons, and try to implement them. If you can't, find yourself an honest and knowledgeable financial advisor — yes, the specimen does exist — to help you achieve your goals.

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The Low-Risk Road to Stupendous Wealth
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