INVESTMENT MANAGEMENT

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Connecting the Dots

Discovering a Multi-bagger

Just the other day, one of the market ‘experts’ on a business news channel while recommending a stock, said that it had the potential to be a multi-bagger. Overall market sentiment has been subdued over the last five years and we were hearing the word multi-bagger after quite some time. Our mind raced back to the analyst meet of a technology sector company during the rah-rah days of the late 1990s. Hosted in the banquet hall of a five star hotel, the setting resembled a rock show replete with hi-tech stereos blasting heavy metal music. The investors at the event were vying with each other to advocate stocks in their personal portfolios that had been multi-baggers in a matter of just a couple of years. After all, Infosys, the poster boy of the late 1990s, was up 75 times over three years from 1996 to 1999. Moreover, during the same period, 25 stocks in the technology sector were up at least 10 times.

Multi-bagger is one of those words, used colloquially, ever so often among the investment community, but does not seem to find a place in the dictionary. Wikipedia has a reference to the word ‘ten-bagger’ on a page devoted to legendary investor Peter Lynch. Apparently, it was Peter Lynch, who first coined the term ten-bagger in a financial context. This refers to an investment that is now worth ten times its original purchase price and comes from baseball where ‘bags’ or ‘bases’ that a runner reaches are the measure of the success of a play.

To many an investor, the holy grail of investing is to seek out a multi-bagger. After all, why take the trouble of painstakingly building a diversified portfolio, churning it periodically and, if lucky, just about marginally beating the markets, when one can find that multi-bagger stock and handsomely beat the returns not just of the stock market but across all asset classes on the planet. Hence, the multi-million dollar question is, how does one discover a potential multi-bagger. In fact, this is where the folly lies.

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The truth is we often obsess about the end-result rather than the process. If the process is right, the results will eventually be right as well. To use a cricketing analogy, every coach drills it into a rookie batsman not to play pre-determined shots i.e. decide in advance what shot is to be played even before the delivery is bowled. The coach's emphasis is on the right technique, and playing each delivery on its merit. Similarly, as any seasoned investor would vouch, rarely does a stock ever portend its multi-bagger potential right from the start. Conviction is built step by step, quarter after quarter. As the Motley Fool website rightly says, "if your investing technique is to seek baggers, your portfolio will likely consist of a lot of 0-baggers, or at least a lot of somewhere between 0 and 1 baggers, and probably a few negative baggers!!" There is no divine process to find multi-baggers. In short, no short cuts.

For an investor, the starting point is to look for a good investment, rather than actively seek out a multi-bagger. There is no substitute to adopting a rigorous investment evaluation process to look for stocks that meet the investable criteria. Moreover, as with every stock price chart, the move is also rarely linear, with many a headwinds and tailwinds along the path. The right ingredients for a multi-bagger include a mix of good management, sector tailwinds and ability to scale up, sprinkled with a generous dose of luck. As Michael Mauboussin, author of the book 'Success Equation' says, "few people acknowledge or care to accept the central role that luck plays in our lives". Add to this, the general lack of patience from most investors to hold on to the stock. Often investors buy the right stocks but exit in a hurry after they have made what they consider reasonable returns, causing unnecessary churn and expenses in the portfolio and the difficulty of continuously finding great stock ideas to replace in the portfolio. Most of us have experienced or met with investors who may have picked stocks that eventually went on to become multi-baggers but they just did not have the patience to hold on to them long enough. When the ingredients for a good investment are in place, all one needs to do is to check periodically if the original thesis or investment rationale still holds good, or is getting better. Patience to hold on, and to distinguish short-term turbulence and differentiate that from a weakening of the investment thesis is extremely important.

While we know that the art of selling is just as important, one should sell only when the investment thesis of owning the stock gets diluted. If it is merely short-term turbulence, i.e. the original thesis is still intact, it is important to continue the faith in the stock.

To conclude, the truth is that you never seek out a multi-bagger. All you do is tick the boxes of your investment checklist and diligently monitor the investment thesis. As the Danish philosopher, Soren Kierkagaard has said that "Life can only be understood backwards, but it must be lived forwards". So too only with hindsight do we realise a multi-bagger. Seasons' greetings and happy investing.

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