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ValueWalk: You're the author of The Emotionally Intelligent Investor: How self-awareness, empathy and intuition drive performance. Could you tell our readers a little about this book and what inspired you to write it?

Ravee Mehta: I came up with the idea of the book after attending a Berkshire Hathaway Inc. annual meeting. I saw a stadium full of people trying to be like Warren Buffett. While Buffett is certainly a great investor, some of the successful investors I worked for and know would have been failures if they tried to be exactly like him. They were good investors because they adopted investment styles that fit their personality traits and motivations for investing. I also felt like there were a lot of books about how emotions are harmful to investing, but almost nothing out there about some of the helpful emotions. For example, many of the best investors utilize empathy, which is what allows them to take advantage of the behavioral mistakes of others. While many value investors talk about screening tools, I think the best investors actually heavily rely on intuition for idea generation. They also utilize gut instincts for things such as evaluation of management, position sizing and sensing danger. Intuition is not a magical sixth sense. It is a complex feeling that arises from pattern recognition. The book is broken down into three parts: Self Awareness, Empathy and Intuition. In part 1, I try to develop a framework for introspection as an investor and then how to develop an investment approach that is best suited to who you are. I also go over the most common behavioral biases and some tactics for dealing with those vulnerabilities. In part 2, I discuss how an investment edge can be achieved through empathizing with other market participants. I provide some tools for developing an empathetic "edge." In Part 3, I discuss intuition - how to effectively and safely use it and how to develop it. While I think gut instincts are important, they need to be safeguarded through analysis. Traditional analysis still takes up the bulk of my time, but better use of intuition and empathy has definitely made me a better investor.

In your opinion, what's the best strategy for investors to use to reduce the impact emotions have on their investment strategy?

Once one becomes aware of the behavioral biases one is most susceptible to, one can develop habits and processes that mitigate their impact. For example, I have a tendency to want to sell my winners too early. This is linked to a fear of regret. Failing to sell a winner opens up the possibility of an eventual loss, which could make me feel regret or shame. Understanding this weakness has made me incorporate processes for deciding whether to exit a position in order to reduce the impact emotions can have. I also sometimes trim a small percentage of winners as they go up, especially if they are up a lot into events such as quarterly earnings. This allows me to keep my emotional equilibrium so future investment decisions are not impacted. If the stock declines, I feel happy that I trimmed a small amount and can buy it back. If the stock goes up, I am also happy because I only trimmed a very small amount. This may not be optimal for long term returns on any given position, but maintaining my emotional equilibrium keeps me from making mistakes with new investments or with trading other positions in the portfolio. My approach works for me and may not work for others, who do not fear regret to the same extent I do. I view investing as a vehicle for introspection and self-improvement. By objectively reviewing my mistakes and successes, I am constantly learning more about myself. I then try to use newfound knowledge about myself to develop processes and habits that will make me a better investor and less vulnerable to behavioral biases. It is a constant evolution.

Could tell our readers a little bit about Nishkama Capital LLC?

Nishkama Capital LLC is an investment manager that manages private hedge funds. We have been in business for over 2 years. As stated above, we look for stocks that are not just cheap, but also where we can identify incremental buyers. The empathetic edge is gained in a lot of different ways, but we make a couple of big assumptions. First, we believe the hedge fund industry is currently very crowded. This often makes hedge funds the incremental buyers and sellers of stocks. We therefore look to initiate on positions that are not well owned by hedge funds. Another big assumption we make is that growth investors pay higher multiples than value investors. Consequently, we prefer buying stocks with (i) either a value or Growth-At-A-Reasonable-Price ("GARP") type of shareholder base and (ii) something fundamentally changing that could get an incremental growth investor excited. We don't like stocks that are just cheap but where we cannot envision anybody other than a value investor owning it. For example, before Apple Inc. released the iPod, it was a value stock trading close to cash for quite a while. The introduction of the iPod was what got incremental GARP investors interested. This GARP shareholder base then transitioned to growth and momentum type investors after the iPhone was introduced. We look for positive fundamental changes such as new products, new businesses, new management, industry consolidation, reductions in regulatory or technology risks, etc. that might get an incremental growth investor interested. We also generally avoid initiating on stocks that are already owned by a lot of growth investors.

Do you factor behavioral investing ideas into your day-to-day investment activities at Nishkama Capital?

When I took time off to write The Emotionally Intelligent Investor, I reflected on my prior investing successes and failures. When I did that I realized that my biggest successes came from when I had both strong analysis and what I call an empathetic edge. The empathetic edge involves taking advantage of the behavioral mistakes of other market participants. It allows one to better understand why the investment opportunity exits. It involves empathizing with both current shareholders and being able to identify incremental buyers. I only want to be involved in stocks where I have both an analytic edge and empathetic edge. As stated above, our investment processes are also highly influenced by my own specific behavioral vulnerabilities.

Value investing generally involves being contrarian and betting against momentum. It can be successful over the long term, but can be very painful in the short term. Benjamin Graham bought deeply undervalued stocks. Warren Buffett evolved to buy undervalued stocks that were also great businesses. We further restrict ourselves to buy undervalued, great businesses that are experiencing positive fundamental change that would get incremental growth type shareholders interested. This approach allows us to effectively add a timing element to traditional value investing.

Your focus is on the tech, media, and telecoms sector. What do you look for in a prospective investment and how do you go about finding ideas?

We constantly read newspapers, blogs, sell-side and buy-side research. Our goal in doing all this is to recognize a pattern that can cause shareholder transitions. Our first step is to try to make an analogy with a prior successful investment. For example, Integrated Device Technology Inc. ("IDTI") was a stock that we successfully invested in 2014. We have since exited this investment but in some ways it initially reminded me of Apple and the Ipod. It primarily had a value-oriented shareholder base and had an exciting new product for wireless charging, which I learned about from reading a short sell-side note in my inbox. This product is what made incremental growth-oriented investors interested in the stock. While our idea generation starts with pattern recognition, we then spend most of our time doing the analysis to safeguard that initial gut instinct. In the case of IDTI, we reached out too many industry experts to understand the potential for wireless charging as a market and the company's competitive lead.

We also spent a fair amount of time developing a detailed financial model. I used to play a lot of chess, and in many ways, we employ a similar process that chess players use. Chess grandmasters usually know their next move within a few seconds. Instead of suppressing their emotions, they first utilize gut instincts regarding their best possible move depending on how the pieces are laid out on the board. These grandmasters then use their reason to make sure the move is safe. If the initial gut feeling is found to be flawed, they start the cycle again with another intuitive feeling.

What's your average annual portfolio turnover?

We generally add about one new core idea a month. Our top 10 core positions constitute anywhere between 40-80% of our assets under management. While we may trade around these core positions, we generally look to hold a substantial portion for at least a year.

Nishkama runs both a long and short book. What traits do you look for when you're evaluating potential short positions?

Unlike other investment managers that tend to focus on bad businesses, frauds and fads, we generally look to short decent companies, but where there is negative marginal change causing a shareholder transition. We short both "value traps" and "broken momentum" stocks. "Value traps" are primarily owned by value investors that we think can transition to deeper value or distressed holders. This usually occurs when the value investors realize that sustainable earnings power is lower than what they had thought. "Broken momentum" stocks are primarily owned by growth / momentum investors that we think will transition to value or GARP type holders over time. This transition can occur because of slowing growth, increasing competition, increased regulatory risk or for various other reasons. The disadvantage of avoiding frauds, fads and bad businesses on the short side is that we do not have shorts that go to zero. However, the offsetting advantages are numerous. First, we are playing in a less competitive area and have less borrow costs. Second, we have a natural factor balance in our portfolio, which reduces volatility. We are long and short decent quality companies. This balance can help in years (like so far in 2016) when low quality stocks significantly outperform high quality stocks. We also have a style balance. We are long and short both value and growth stocks. Third, we can better leverage institutional knowledge that gets built up. When one shorts a fraud, fad or a bad business, one makes money or loses money and moves on. All of that financial modeling, building of relationships with management and industry experts, and company and industry specific knowledge goes out the window. However, when one shorts a good quality business because of negative marginal change, one can potentially leverage all that work at some point down the road to go long that same stock when there is positive marginal change that causes a shareholder transition to occur in reverse.

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