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Coffee Can Investing: The Low-Risk Road to Stupendous Wealth

Author: Saurabh Mukherjea, Rakshit Ranjan and Pranab Uniyal

Book Summary

As an investor, who do you look to, for financial advice? Is it your bank relationship manager, who prompts you to safeguard your money by relegating it to a fixed deposit, or your friend or relative, who has spent some time in the stock market? Wherever you turn, you will be met with a bevy of conflicting information and advice, leading to confusion and possibly the wrong decision. And, as every investor worth their salt will tell you, there is no way to ascertain exactly how much a bad decision could cost. In this scenario, most investors find themselves feeling disheartened by the lack of precise guidance and this is where Coffee Can Investing: The Low-Risk Road to Stupendous Wealth, penned by Saurabh Mukherjea, Rakshit Ranjan and Pranab Uniyal comes into the picture.

This solemn guide to investing revolves around the core concept of the "Coffee Can Portfolio," pioneered by Robert Kirby of the American investment giant Capital, and is centered on a long-term investment approach. In this strategy, investors purchase stocks and hold onto them for an extended period, essentially forgetting about them, for the term "Coffee Can Portfolio" finds its roots in the pre-banking era, a time when individuals used to safeguard their savings by stashing valuables in a coffee can hidden beneath their mattresses. The book provides readers with a concise and engaging overview of the history of investment in India in a manner that keeps the subject matter interesting and approachable, shedding light on various investment instruments and how they have been embraced by the Indian populace over time.

The authors, who were colleagues at Ambit Capital, at the time of writing the book, leveraged their considerable investment knowledge and expertise to bring forth this treatise to potential investors.

Key Takeaways

- Common investment pitfalls include not having a clear plan, trading too frequently, lacking diversification, incurring high fees, pursuing short-term gains, attempting to time the market, and disregarding the effects of inflation and taxes
- Choose to stay invested in fundamentally strong companies during both market ups and downs
- Stocks frequently experience appreciation at times when you least anticipate it, and this appreciation does not occur uniformly across all stocks
- You can invest in equities successfully by answering two simple questions – which stocks to buy and how long to hold them
- You should maintain your eye on companies which depict a sustainable competitive advantage, a robust management team, and a solid addressable market as these facets go a long way towards ensuring optimal growth

As an investor, you are probably assailed with investment tips and guidelines at every touch point, and it becomes extremely difficult to sift through the chaff. Further, there is a big choice to be made – should you be a trader or an investor? And how often should a portfolio be rebalanced or churned? The Coffee Can Investing strategy is an excellent option for investors with a long-term outlook as it helps you avoid unnecessary market tracking and timing, while ensuring optimal returns in the long run.

Investing mistakes to avoid

History indicates that, frequently, stocks tend to appreciate when least expected, and their growth is often uneven. Within this context, we can identify seven common investment mistakes that many individuals make and which you should avoid to foster a solid portfolio. To begin with, not having a well-defined investment objective or plan can result in financial misdirection and this, combined with excessive and frequent trading, lacking a long-term focus and prudent asset allocation, often leads to diminished returns and heightened transaction costs. The failure to diversify a portfolio leaves it vulnerable to shocks in specific asset classes, due to the risk and return equation depicted by different assets. Additionally, you should try to avoid the high commissions and fees, which can substantially erode a portfolio's performance over the long term. Further, pursuing short-term returns without a comprehensive understanding of the associated risks is a prevalent blunder, as is trying to time the market as markets exhibit inherent volatility and are challenging to predict accurately. Lastly, overlooking the influence of

inflation and taxes, while concentrating solely on absolute returns can result in misleading assessments of investments.

Three lessons to focus on

Always remember the significance of establishing clear objectives and incorporating them into a financial plan, while also understanding the necessity of moving beyond conventional investments like fixed deposits, real estate, and gold. While these asset classes have been in vogue since decades, it is advisable to diversify your portfolio beyond these, to achieve optimal asset allocation. Further, market participants must invest in equities to create a well-rounded portfolio since, despite their inherent market volatility, as stocks remain a formidable driver of sustainable long-term returns, as long as you approach it with a patient and systematic mindset.

The Coffee Can Strategy

Based on the original strategy, the Indian framework to creating a Coffee Can Portfolio can be delineated as follows –

- Focus on companies which have a market capitalisation over INR 100 crores
- Ensure the selected companies indicate a revenue growth of a minimum of 10% per year, over the last decade
- Choose companies which have offered a return on capital employed (pre-tax) amounting to a minimum of 15%, over the last decade
- When choosing companies in the financial services sector, opt for companies depicting a loan growth of a minimum of 15% per year, over the last decade, in addition to minimum of 15% return on equity, each year, in the same period

When you opt for stocks aligning with the afore-mentioned parameters, and hold on to the same for a 10-year period, the portfolio is primed to beat the indices in an optimal manner. This is because the strategy leverages core investment philosophies such as compounding, diversification, and patient and systematic investing, while reducing the negative impact of portfolio churn expenses, which tend to compound over time and thereby eat into your returns.

Stocks adhering to the framework

To indicate the relevance of the framework, you can consider a few companies which have steadily adhered to the Coffee Can stock-picking strategy and indicated sustainable growth.

Picking Coffee Can stocks.

When you create or rebalance your portfolio, remember to look for stocks which align with the imperative 'Good & Clean' framework, which can be divided into two factors –

Greatness factors: You can arrive at companies displaying the greatness factor by analysing metrics such as the investments made by the company, the conversion of such investments into sales, the earnings before interest and tax margin or the company's ability to translate sales to profits, its profits to balance sheet strength, measured by the Debt/Equity and Cash ratios, its ability to generate cash flow from operations and its investment of free cash flow.

Accounting factors: You should further evaluate the company on accounting metrics such as P&L mis-statement, balance sheet mis-statement, pilferage, and audit quality, as these aspects indicate the integrity of the company. A dishonest company can only grow so far, before it gets trapped in its own follies.

Every investor sets out on the investment journey with the ambition of making it big and you can ensure that you achieve your financial goals, as long as you choose to invest for the long-term, in high-quality portfolios, and place a higher weightage on high-quality small-cap companies, while ensuring that you do not spend a high amount on the fees. Finally, by avoiding

traditional investments like real estate and gold, and focusing on the growth potential of equities, you can arrive at significant and sustainable wealth creation, thus charting a successful investment journey.

It is important to acknowledge that as an individual investor it might be challenging for you to do the in-depth analysis required to select the right kind of stocks and then stay invested during market ups and downs. However, that does not mean that you cannot benefit from this investing approach. You can always consider investing via mutual funds. Mutual funds are managed by experienced professionals who invest your money in different funds that can be categorised based on their asset class, risk, strategy, etc. This way, you can get the desired exposure without having to spend time and energy on stock selection. Further, when you invest in mutual funds via the Systematic Investment Plan (SIP) route, you will be able to approach investing in a disciplined manner and be better able to handle equity market volatility.

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