

Here's the secret to acquiring a portfolio of multibagger stocks

Devina Mehra | 25 Sep 2024



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SUMMARY

Making market bets that'll prove to be big winners over the long-haul requires an investor to choose a portfolio of at least 25 to 30 stocks across sectors, after due thought and analysis. Of these, one can expect 2-4 picks to come good.

If I had got even ₹10 for each time I was asked a version of this question, I could have a few lakhs on this account alone!

And the question is: What's the next HDFC Bank or Amazon that we can buy and forget for 25 years? Or can you tell me one stock I can buy for my infant daughter or son so that they have a huge corpus when they grow up?

First the back story. First Global had a 'Strong Buy' on Amazon at a price of \$15 (split-adjusted \$0.75) back in 2001, post the tech crash.

This was at a time when there was no other 'Buy,' let alone a 'Strong Buy' from any firm on Wall Street. In fact, Jeff Bezos sent us an email thanking us for the support.

At the very same time, BusinessWeek and other major business magazines were predicting bankruptcy for Amazon. Even all the Wall Street firms, which had been

big supporters and promoters of Amazon, were now ‘throwing in the towel’ on the stock, as they put it.

The ride since then is there for everyone to see.

Similarly, we had a ‘Buy’ on HDFC Bank at a price of ₹38 (split-adjusted ₹3.8) in 1996, just a year after its initial public offering (IPO). On the cover of our research report was a picture of a baby, saying that this is where the company was then.

And it had Mr. Universe, Arnold Schwarzenegger with a blurb saying that this was where the bank was headed. We have all seen that transformation play out over time, with HDFC Bank becoming the 800-pound- gorilla in the banking business.

Both these calls were based on analysis of business prospects, financials and so on. For example, Amazon had made a free cash flow of over \$200 million in the preceding quarter after having been free-cash-flow negative all along.

It was clear that it was in no danger of going bankrupt, which is what the rest of the Street was pricing in. So, we were confident enough not just to have a ‘Buy,’ but a ‘Strong Buy’ on the stock.

In the case of HDFC Bank, it was a market bet on strong banking-sector growth post-liberalization as well as the prospect of an efficient and well branded private player taking away share from public sector banks that were the only players of size at the time.

There was also the secret ingredient of my knowing the management of the bank and hence being more confident of risk management, which is a critical component in the success of any lending business.

But here’s the thing: When you are writing a report like this, the visibility of the business’s or stock’s future prospects is not for 20-25 years, or even a decade. At best, at that stage, you can only say that Amazon at \$15 will go to \$50 or a ₹38 HDFC Bank to ₹100 or possibly ₹150.

Even Aditya Puri and Jeff Bezos, who headed these companies, could not have foreseen the full extent of the business or stock price trajectory. Yes, they may have been confident of their businesses doing well, but not that the stock would give thousands of percent in returns.

Jeff Bezos may have wanted to become the world’s richest man. But could he have said 20 years ago that he would get there even for a day? No way.

The truth is that no one can know beforehand which stocks in a portfolio become multibaggers. Anyone who tells you otherwise is only fooling you, and maybe themselves.

Rakesh Jhunjhunwala, known for his acumen as an investor, could not have predicted upfront that Titan, Crisil, Lupin Labs and a couple of others in his portfolio would wipe out the sins of many more losers that went nowhere.

Warren Buffett himself has said that in over 70 plus years of investing, net of his top few calls, the rest of the portfolio has been below average. He put the winning stocks at about a dozen. His recently deceased partner, Charlie Munger, put the number even lower at about four or five.

No one can build a portfolio of only multibaggers. Or even 80-60% multibaggers. In the history of the world, there has not been a single investor or fund manager who has been able to do this.

Don't get fooled by stories of great long-term foresight. Life is about probabilities and at every stage, there are multiple outcomes possible for every single company or stock.

The formula for winning in this game is to have a well chosen portfolio of at least 25 to 30 stocks, across sectors. This too should not be a random portfolio, but one built with a great deal of thought and analysis, and in accordance with a system.

Still, be prepared that some of the picks will turn out to be duds. As a rule-of-thumb, you may find possibly five are near write-offs, another five do nothing very much either way, 10-12 give you reasonable returns, and then, and only if you have chosen well and are lucky, there is a likelihood that two to four of them will turn out to be multibaggers.

Any story of multibaggers conveniently forgets all the other stocks that looked equally promising at the same point in time but did not give anywhere close to the same returns over the long-term. It is the classic survivorship bias.

The bottom line: To get those elusive multi-baggers, you have to cast the net wide, rather than convince yourself that you have found the one or two stocks that will perform to eternity.

Devina Mehra is chairperson, managing director and founder of First Global, an Indian and global asset management company, and author of the forthcoming 'Myths and Mantras: The Ultimate Investment Guide'. Her X handle is @devinamehra