

IPO investing: The challenge is to be a bigger genius than Isaac Newton

Devina Mehra | 11 Sep 2024, 02:00 PM IST



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SUMMARY

Today's market frenzy over share issues shouldn't lead investors to forget how the savviest of investors have suffered from bubble bursts. Isaac Newton, who was no financial rookie, also got swayed by groupthink and lost much of his wealth to the South Sea Bubble in the early 18th century.

The Securities and Exchange Board of India (Sebi) released a research paper recently on the IPO (Initial Public Offering) market, and a figure that leapt out was that more than half of the IPO shares allotted to individual investors are sold within a week. The study was from 2021 to 2023, and given the market frenzy thereafter, the proportion of quick flipping would have only increased.

As for fund-raising, in the first eight months of 2024, ₹53,463 crore has been raised in the IPO market versus ₹15,052 crore in the period from January to August 2023. The August 2024 figure is ₹17,000 crore, more than what was raised cumulatively in the first eight month last year (source: Prime Database).

Nor are IPOs the only way money is being raised. Qualified Institutional Placements (QIPs), by which companies raise money from institutional investors, are also on a high. Up to August 2024, the amount raised has already exceeded that for the full year of 2023 and is more than the total of 2021 and 2022 combined.

Then there are block deals, which are large transactions in the secondary market, typically involving institutional investors or company promoters. Here too, the numbers have been extraordinarily high. In August, there was a single week where block deals exceeded ₹20,000 crore.

Putting all the data together, the following points are clear:

One: Companies as well as large shareholders of companies like promoters, venture capital institutions, etc, have been selling substantial quantities in the market.

Two: Individual investors have been buying not because they love these companies or agree with the IPO valuations, but because they hope to get out with a profit in the very short term. In financial markets, this is called the 'greater fool' theory, where you buy something not because you think it's a wonderful investment but because you are confident of finding a greater fool who will buy it from you at a higher price.

Three: Sebi data also shows that 85% of IPO investors have been in the market for less than eight years and a majority have come in post-covid. Hence, they have not lived through market cycles.

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In India, 1,366 new stocks got listed in 1994-95 and 1,402 the subsequent year. And this is Paris in 1881: 400 new listings, waiters risking their money in the stock market, prospectuses being handed out with street food—this movie has played out multiple times in diverse geographies.

There is a fitting quote in French that goes: "*Plus ça change, plus c'est la même chose*" or "the more things change, the more they stay the same." Or take one of my favourite quotes ever, from John Kenneth Galbraith's *A Short History of Financial Euphoria*: "There can be few fields of human endeavour in which history counts for so little as in the world of finance."

One of the key points that Galbraith emphasizes in his characterization of a bubble is that it is not as if everybody participating in a bubble believes in it. Many who see the problems still jump in, thinking they can get out ahead of the crowd or the dumb money.

But when the bust comes, it arrives with a bang. Thus, all those who planned to exit find they cannot, at least not without a big hit.

A bust is often followed by a blame game. Some heads have to be sacrificed: whether of corporations, other entities or people. What remain sacrosanct are markets and 'common' speculators. They are never blamed, but perhaps should be.

As a recent example, the crypto/non-fungible token frenzy of 2021 was more about people thinking they had found a way to quickly multiply their money than their being misled.

And what about Isaac Newton, the genius who made at least three path-breaking contributions to science?

Newton crossed paths with the South Sea Company, immortalized in history and even Charles Dickens books as one of the big bubbles of the 18th century. It was a stock that had an amazing price rise and then a crash that wiped out a number of fortunes.

In between were fancy promises that never had hope of being fulfilled, insider trading, bribery, connections in high places et al, but with no shortage of investors who were willing to bet on it.

Among them was Newton.

As Andrew Odlyzko writes in 'Isaac Newton and the perils of the financial South Sea' in *Physics Today*: "Newton was an early investor and profited nicely as the price of South Sea stock rose over the course of the 1710s. However, in 1720 the company's stock experienced one of the most legendary rises and falls in financial history.

Newton decided in the early stages of that mania that it was going to end badly and liquidated his stake at a large profit. But the bubble kept inflating, and Newton jumped back in almost at the peak... Despite Newton's general brilliance and his expertise in finance, groupthink led him to plunge into the South Sea Bubble and lose much of his fortune."

Mind you, Newton was no financial rookie. At the time of this crash, he was Britain's master of the Royal Mint, a post he held for decades.

The bottom line is that in this game of musical chairs, when the music stops, not just one chair but almost all the chairs are whisked away and everybody is out of the game in one shot.

Play the game only if you're more of a genius than Isaac Newton.

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