Three P's of investing

This is going to be a series on valuation – we will be discussing the "value investing" approach.

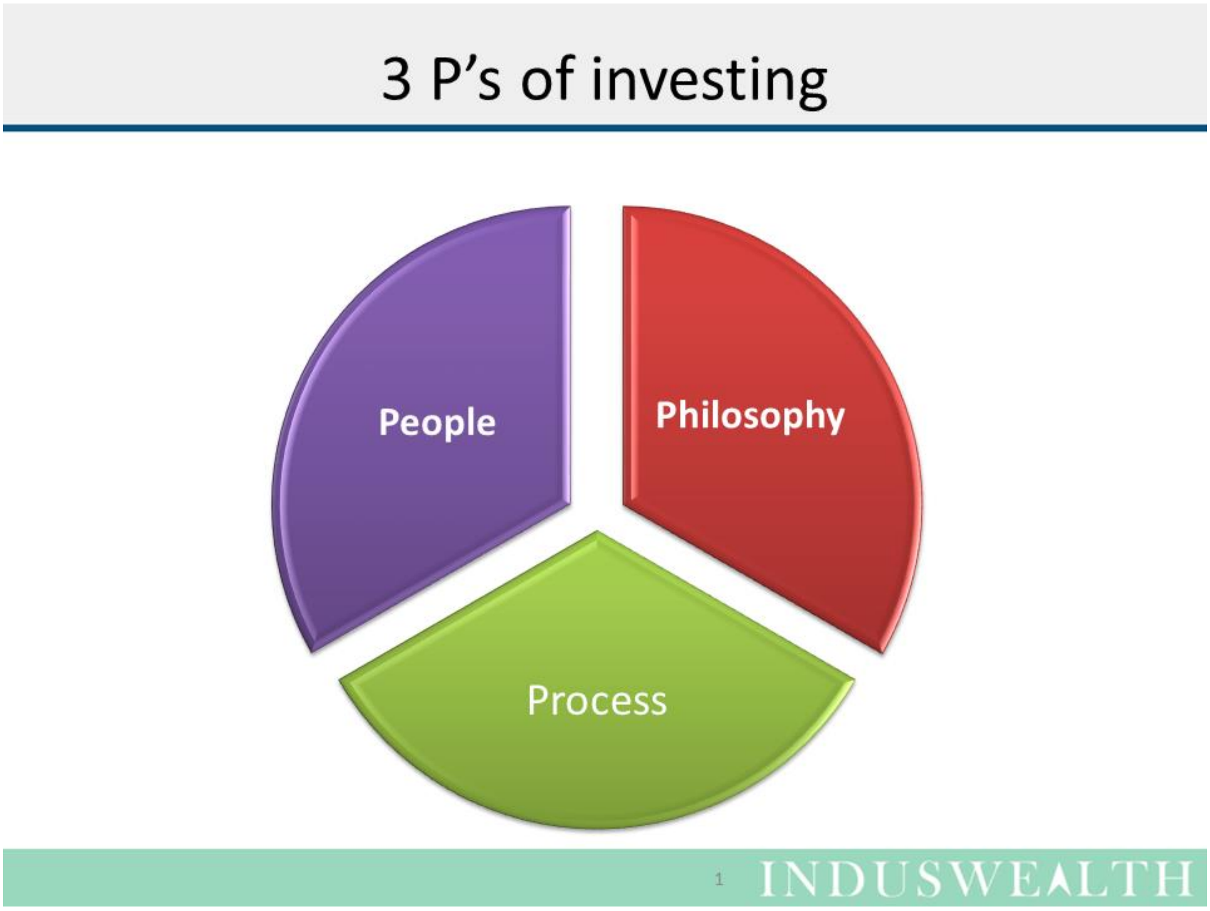
Before we embark on valuation we want to discuss the 3 P's of investing, we believe that a clear understanding of the 3 P's is crucial for investment success.

Philosophy: Investing philosophy is the set of underlying beliefs that will drive your investment approach. For instance – there are value investors who will invest only when the valuations are reasonable, contrarian investors who will do the opposite of the crowd, technical investors who will invest based on the charts, Black swan investors will take bets on rare events and expect a high pay off when such events happen etc. All these philosophies give a lens from which one can view the market, its participants and spot profitable opportunities. All of these philosophies have blind spots and caveats that need to be well understood to be a successful.

Philosophy	Key belief	Blind spots/challenges
Value investing	Based on understanding the business fundamentals a specific value can be assigned to a stock which may be different from the market value, hence profitable opportunities can be spotted	Value arrived through the valuation process has many assumptions (discount rate, rate of growth etc.,) that are very subjective. Valuation can vary significantly based on the assumptions used.
Contrarian investing	Crowd behaviour is often wrong, and hence profitable opportunities can be spotted.	Clarity of understanding of the underlying reasons will be a key. Markets can stay irrational for longer than investors can stay solvent.
Technical investing	Patterns consistently repeat in the market as they are a reflection of human behaviour and hence profitable opportunities can be spotted.	Potential to confuse signal and noise. One looks hard enough patterns can be found, but they may not have a causal relationships.
Black swan investing	People are unable to account of the extreme events and extreme events in real life are not as rare as statistics predict and hence profitable opportunities can be spotted.	Ability to stay solvent is the key here, in this philosophy people will lose small amounts on a regular basis and will win big when rare events happen. Key will be to predict the magnitude and direction the extreme event.

Process: This is the framework that is evolved to put philosophy into practice. This **involves methods used for identification of opportunities, tools to review current investments and frequency of review.** Though the "process" seems/feels mundane – but it is one of the key aspects for successful investing. All the philosophies can be made to work if there is a good process and the greatest philosophies will fail if the process is sub-par. Processes should be "live", all philosophies have their lacunae and the process need to continue to evolve based on the feedback so that many of these lacunae are addressed as and when they are discovered.

People: Just like in any other aspect of life, investing also needs right kind of people to succeed. It is the responsibility of the people to understand the philosophy and its bind spots, to follow the process in a disciplined manner and have the discipline to update the process from time to time. When we talk about the people, this is less about the intellect and more about individual discipline. Very few geniuses have been great investors, whereas all the great investors have (and had) a disciplined approach to investing.



In summary - **Philosophy** drives the investment strategy, **process** gives the framework for executing the strategy and **people** are responsible for understanding the strategy and exercising discipline in executing the strategy. All these 3 P's are essential for investment success.

Happy investing.