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AJIT DAYAL
Founder, Quantum Mutual Fund

‘Earnings for 2017 are likely to be lower than earnings in 2014’

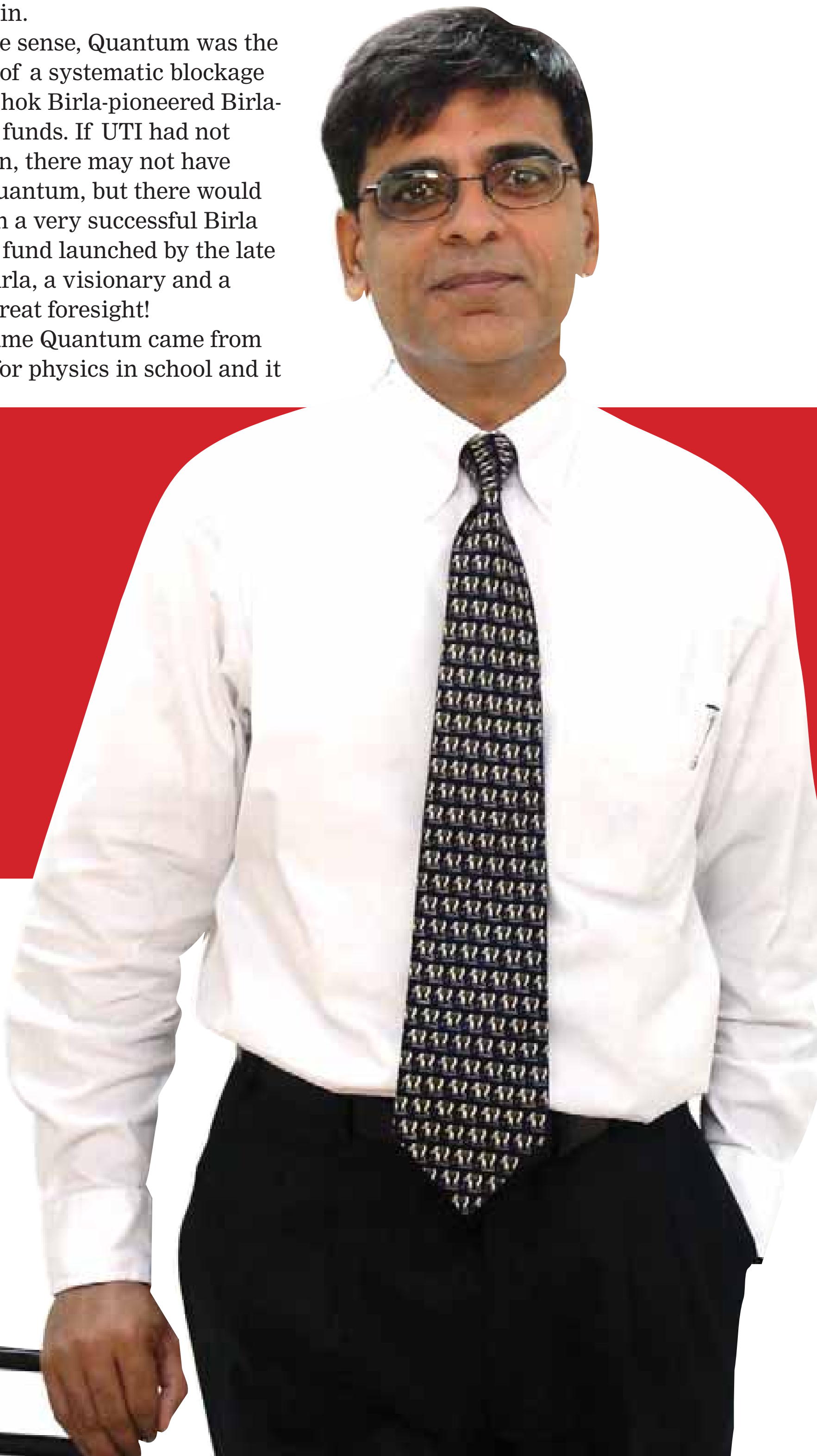
Call him a maverick but the truth is Ajit Dayal’s views about the investing world are bold and border on provocation. A fund manager with the distinction of managing equity assets on a global platform, including the lead manager of the $2 billion Vanguard International Value Fund at one time, Ajit went on to start Quantum AMC. Ajit also worked with value investor Tom Hansberger and received the backing of billionaire Prem Watsa. In an interview with Kumar Shankar Roy, Ajit discusses the journey of Quantum, Indian stock market evolution and his own investment approach.

How did Quantum start?

I was privileged to have met Mr Ashok Birla, who is actually the father of the Indian mutual fund industry. He was the first person to propose the idea of raising money from NRIs and overseas investors via a structured mutual fund route. UTI’s popular Unit Scheme 64 was really a Ponzi scheme because its NAV (net asset value) was not linked to market prices and yet its payout was a known amount. It eventually imploded on the back of guaranteed payouts and lack of transparency on how investments were made and valued. A bureaucrat in New Delhi told me that the Birla idea would never see the light of day because UTI was blocking it. Finally, UTI did receive the approval for an offshore fund with Hemendra Kothari’s DSP and Merrill Lynch as the placement and marketing agent. I transferred my efforts into assisting foreign investors in evaluating the Indian economy and identifying sectors and companies to invest in.

In some sense, Quantum was the outcome of a systematic blockage of the Ashok Birla-pioneered Birla-Warburg funds. If UTI had not stepped in, there may not have been a Quantum, but there would have been a very successful Birla Warburg fund launched by the late Ashok Birla, a visionary and a man of great foresight!

The name Quantum came from my love for physics in school and it reflected the task ahead: to take India’s financial markets on an orbit from a lower level of controls and inward-looking policies to a higher orbit of financial openness and integration with the global economy.



When did you think of setting up a money-management firm? And how did this business evolve?
When we partnered Jardine Fleming in 1992, it had a general manager for India but my role was to identify key people to head every silo and ensure that the businesses were moving in the right direction.

But the field of finance was populated by local brokers with questionable practices prior to the 1991 liberalisation of the Indian economy. Since then, the dress code of people working in the industry has changed (from *dhotis* to suits), as has the intensity of suspect practices. The field of finance – in India and globally – has failed to focus on what is good for their customers. They have focused on what is good for their business. And they seem to be proud of it. If you head to a doctor and ask for ten shots of morphine, we think it is the doctor's job to warn you of the consequences of taking those ten shots and refuse to give you what you want. Financial geniuses think otherwise. As financial doctors, they are willing to give you whatever level of spice you may ask for, even if you don't understand the product or the consequences of trying to digest such spicy food!

So, the Quantum that you see today is a by-product of two states of reality in our industry: firstly, for our competitors, customers can be acquired or squeezed at will. Secondly, we are firm believers in processes and teams that oversee research and investments to ensure that our investors have very predictable outcomes when they invest in our mutual funds.

All of us at Quantum are not vegetarians, but we follow some of the basic tenets of Gandhi: focus on what is good for the customers, be honest, be transparent, be simple. We wish to help investors break free from the clutches of the existing practices of financial firms by offering them a combination of integrity and competence. It is worth noting that SEBI, under the chairmanship of Mr Bhave and then Mr Sinha, has done a lot to help clean up the muck in the mutual fund industry.

How and when did you come about venturing into domestic asset-management business?
The Birla Warburg proposed venture in 1984 was for a fund launched outside India to invest in India. My first tryst with the domestic industry was during the Jardine Fleming Quantum days, when we got our AMC license in 1994. But then I left JF in 1995.

So, by 1996 I was 'AMC-less' again. SEBI required a sponsor to have a net worth of ₹3 crore to apply for an AMC licence. I did not have that. Then we were fortunate to meet Tom Hansberger, the co-founder of Templeton, Galbraith, and Hansberger (now known as Franklin Templeton) in 1997. Tom had started his own firm in 1994 (Quantum, it should be noted, was founded four years before that in 1990) and from 1997 till 2003 I lived mostly in Florida, learning from a master the basics of value investing. However, Tom was also meant to give us capital by being a 50 per cent shareholder in Quantum so that we could apply for the AMC licence. That did not happen. So, in a sad twist of fate partially triggered by a family situation, I left my guru and returned to India to find a partner.

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In 2004, six of my friends gave us the capital to start Quantum AMC. Between 2004 and 2016, over that 12-year period, my friends and well-wishers left us alone to build one of the most-respected investment firms in India. The dream was finally there. In 1990, I sat with Dr Dave (former chairman of SEBI) and some of the team from IDBI that was seconded to the nascent SEBI to help write the rules for the birth of mutual funds in India. In 2006, 26 years later, we finally launched Quantum Mutual Fund.

How would you rate Quantum Asset Management as a business?
We really don't see ourselves as a business. We are professionals. We invest your hard-earned savings, your capital. But, yes, we have to pay salaries, so we need revenues. For this, we need to be good at our work. In Quantum, we have assembled a team of people who have worked hard and have comfort in the knowledge that they will never be asked to do anything against what the research and investment processes tell us. The sales and marketing team will never mislead to sell.

Since our launch, we have not been able to work with the distribution channels because they did not reveal the commissions they earn to their clients. Quantum Mutual Fund refused to work within the opaque commission structure. But the rules have changed now and IFAs (independent financial advisors) and RIAs (registered investment advisors) will need to disclose the commissions they earn from each fund house to their clients. Therefore, we are now ready to work with the IFAs and RIAs. Quantum has even launched, for the first time, a regular plan which allows the distributors who recommend our plans to earn 0.15 to 0.25 per cent per annum for bringing in the client.

How have things changed in the stock market since the 80s?

The daily trading volume used to be about ₹5 crore then; today, it is ₹25,000 crore – a jump of 5,000 times. Stocks were priced on connectivity with governments. Today there is some of that still, but there are many companies whose future is a function of what choices and decisions the consumer makes. In the 1980s, there was no computer trading, so brokers who had access to the rarely working Department of Telecom lines had an edge in pricing. That arbitrage was shut down when communications improved. However, the allegation that a few people got to trade on the NSE a few milliseconds ahead of everyone else shows that faster speeds will not necessarily change the ethical behaviour of people.

As an investor, how has your approach changed in the way you view Indian stock investments over the years?

We learn every day. We learn new things from the mistakes we have made. Jardine Fleming was a momentum, bull manager. They taught me how to place India on the global map relative to other emerging-market countries and the developed world. But their analysis, in hindsight, lacked rigour. Tom Hansberger, as a legendary value investor, taught us to compare the Indian companies in our universe with peers in the developed world. As the Indian economy integrates more and is more open to foreign goods, we will need to be aware of sectoral trends globally. Tom Hansberger taught us patience and showed us why working as a team is far better than creating a brilliant shooting star.

Your view seems to be that people in financial markets are generally crooked. With this premise, how do you go about investing?

As a trustee of others' capital, we have to worry about two things: the lack of transparency in the financial-distribution channels and then the lack of integrity amongst many founders or promoters of companies. There is crookedness which may distort how you allocate your savings. And there is crookedness in the companies your money is invested in.

Many years ago, before I started Quantum, I met a banker from South Africa. When I told him I wanted to start an investment-advisory firm, he told me to remem-

ber one rule: "When you shake someone's hand, count how many fingers you have left. If it's less than five fingers, then don't shake their hand again!" It is a rule that I have followed and ensured that my colleagues have understood.

Many Indian founders have this view that they are doing us a favour by giving us an opportunity to invest in their great idea. If the idea turns out to be good and the company is profitable, the promoters believe they have the right to limit the profit the external investors make. If the idea is bad, then tough luck to both – but the founder may have milked the company or extracted his capital out in the meantime. So, we do have a list of promoters or founders that we will not invest with.

How would you describe your investment approach?

We are bottom-up, long-term, value investors. What this means is that we focus on managements, the businesses they run, the competition that exists and that is likely to emerge, and the dynamics of the sector. Long-term perspective means that we have zero interest in what happens in one quarter or even in one year. Our focus is looking out five years. However, we recognise that it is fuzzy and hazy to have a view of numbers five years out. So, while we visualise what a company or a business will look like five years from now, we tend to look at valuations of the business two years out. If the current share price of the stock is above what we think is the 'value' price level at which we are willing to buy, then we will not buy the stock. We will wait patiently for the market price to decline below the value-determined buy limits. That takes discipline and an immense faith in the processes we have built and in the team that manages the process.

Tell us about your personal investments and what is the approach behind them?

My personal investment is in a range of Quantum Mutual Funds. We eat what we cook. If it is not good for me, it is not good for you.

What are your views on the current valuation in the market?

The earnings of the index in March 2017 are likely to be lower than the reported earnings of December 2014. So, share prices have risen on hope, not on earnings growth. We continue to like India for the long term but have advised our clients to keep India as an underweight. WI