The oft-forgotten ingredient in Investing

Dear Investor,

An incredible amount of time is spent by too many people in predicting the movement of the stock market index, or that of individual stocks. And many times, we have observed that the prediction is done using a one-to-one correlation between a plausible cause and outcome. These predictions happen about macroeconomic indicators, socio-political factors, new inventions, trends in new industries, and several other factors. Sometimes, it is accompanied by unbridled optimism, and sometimes, by uncontrolled pessimism. Let us look at this with some examples.

The Covid-19 pandemic

Remember the Covid-19 pandemic? The initial scare, the lock-down, the fear of going out, the spurt in the number of cases, the delay in establishment of the treatment protocol, the shortage of medicines, the shortage of hospital beds and oxygen, the deadly Delta wave, the initial slow progress in vaccination, and finally the receding of the fear around the pandemic?

We also remember the wild economic and stock market predictions that abounded during that period. From predicting the end of capitalism as we know it, to equating the world's economy to that of the Titanic hitting an iceberg, and prophecies about the demise of the stock markets, we had seen a variety of predictions.

Now let us look at what actually happened to the stock market during those times:

Wave 1	15 March 2020	30 September 2020	% Change
Active cases	139	9,63,000	
Deaths (cumulative)	1	98,708	
Nifty 50	9,955	11,050	11.0%

Delta wave	15 February 2021	8 May 2021	% Change
Active cases	1,34,032	37,32,423	
Deaths (cumulative)	1,55,851	2,42,399	
Nifty 50	15,163	14,823	-2.2%

Omicron wave	14 December 2021	24 January 2022	% Change
Active cases	87,562	22,36,842	
Deaths (cumulative)	4,76,135	4,90,462	
Nifty 50	16,985	17,617	3.7%

Source: 1) www.incovid19.org 2) NSE

All the dire predictions about the world coming to an end did not come true. Despite the initial panic about the Covid wave in March 2020, the Nifty 50 gave a positive 11% return between March 2020 (when the initial scare hit the market) till September 2020 (the peak of the first wave). The Delta wave between February and May 2021 was deadlier, and the market fell 2.2% during this period. The Omicron wave, which saw a rapid rise in cases again, saw the market rise by 3.7%.

The takeaway is that even a once-in-a-multidecade event like the pandemic does not establish credible stock market predictions.

The war in Ukraine

The war in Ukraine started on 24th February 2022, and saw a plethora of predictions about how the rise in oil and gas prices, and the supply chain disruptions in Europe would play havoc with the world's stock markets. Similar predictions were made about the Indian stock markets.

In the first year after the Ukraine war started, the Nifty 50 index rose by 4.85%. (Source: NSE).

More recently, the war between Israel and Hamas brought about similar predictions. As you know, this war was triggered by the attack on 7th October 2023. On 6th October, the Nifty was at 19653. As we write this newsletter on 30th November, the Nifty trades at 20133.

While talking about these recent wars, it is pertinent to talk about the movement of the stock market during World War II. During the course of the 6-year World War II, the Dow Jones Industrial Average (DJIA) fell by 7.2%. Pertinently, the market bottomed out in 1942, a full 3 years before the war ended in 1945. Between 1942 and 1945, the DJIA rose by 69.5%. (Source: www.macrotrends.net).

Predictions about interest rate movements and the stock market

We have all studied in economics textbooks that interest rates and the stock market have an inverse relationship. The theory is that when interest rates rise, it makes borrowing more expensive for a company, which means that they have less money to invest in the company, and therefore less cash flow stability. And this is supposed to put pressure on share prices. We have also studied that when interest rates fall, the reverse of the above happens.

Now let us look at the movement of interest rates and that of the stock market over the last 25 years:

Movement of the Nifty 50 index and the 10-year government bond yield in India

Source: Bloomberg

(a) Between Oct 2000 and Mar 2004, the Interest rates sharply fell from 11.70% to 5.16, and the Nifty 50 rose by 9.5% per annum during this period.

(b) Between Mar 2004 and July 2008, the Interest rates sharply rose from 5.16% to 9.32%, but the Nifty 50 rose even more sharply by 24.36% per annum during this period.

(c) Between July 2008 and Dec 2008, the interest rates sharply fell from 9.32% to 5.26%, but during this period, the Nifty 50 also fell sharply by 30.96% in this period.

(d) Between Dec 2008 and Nov 2013, the interest rates rose from 5.26% to 8.74%, but the Nifty 50 grew by 15.45% per annum during this period.

(e) Finally, between July 2020 and Nov 2023, the interest rates rose from 5.84% to 7.27%, but the Nifty 50 has grown by 19.62% per annum during this period.

It is definitely not our case that macroeconomic indicators are misleading or irrelevant. It is just that in a multi-variable and complex system like the stock market, making a one-for-one prediction linking one cause with the outcome is, in our opinion, an inadequate response to the whole thing.

Other extrapolations worth remembering:

(a) The Internet boom in early 2000. There was such a hype around the internet and the so-called "new economy" that stocks were willing to be purchased at prices that were far from sustainable. Even Cisco Systems, one the strongest and most-favoured companies at that time, and a poster-boy of the Internet industry, has not regained the price of $80 seen in March 2000, even after 23 years. The stock now trades at $48. It is pertinent also to remember that adjusted for corporate actions, the stock was trading at $2 in March 1995. (Source: Bloomberg).

(b) Closer home (and during the same time), the "new economy" enthusiasm gripped stocks like Visualsoft technologies and Zee. Neither of these stocks (along with several others in the sector at that time) ever saw the price witnessed in early 2000 again.

(c) The mid-2000s saw the aviation industry being touted as the "next big thing" because Indians increasingly used air travel. After less than two decades, two major stocks in that Industry are not even traded today.

(d) Sometime ago, we witnessed a frenzy of enthusiasm around online pharmacies or online grocery delivery systems, as well as the predictions about "new age kitchens" replacing the traditional restaurants. What has actually happened is that these new delivery systems have expanded the market, and both the old and the new have learnt to happily co-exist.

(e) We also, sometime ago, witnessed the frenzy around coaching institutes, with frenetic activity being done in the private equity space. Such enthusiasm (and the valuations around these companies) have again come down to earth.

What is common to all of these instances? Whether it was extreme pessimism regarding the impact of the Covid-19 pandemic or a war situation, or extreme optimism about certain industries and businesses, the common factor was that the extent of overreaction (reflected in the stock's valuation) was ignored while making the investment decision.

This is one of the most significant learnings we can have about investing. The strange part is that in the eagerness to analyse the various economic factors and predict the future movement of stocks, this important ingredient (the valuation brought about by the overreaction of investors towards this new prospect) is forgotten.

It is very relevant here to quote David Dreman from his classic book "Contrarian Investment Strategies – the Next Generation":

> ***"One of the most obvious and consistent variables that can be harnessed into a workable investment strategy is the continuous overreaction of man himself to companies he considers to have excellent or mundane prospects."***

It is difficult to overemphasize the importance of this advice. When being excited about the prospects of an industry or company or being pessimistic about the immediate future of the world, it is a common mistake to ignore the collective overreaction of the participants in the stock market to these factors.

Being aware of this overreaction, whether positive or negative, **does** make a difference to our portfolio. It is a simple thing, actually, but is not easy to implement. What makes it difficult, dear Investor, is the peer pressure of attempting to be the "best" always or attempting to earn the "highest returns" always.

Just by getting rid of this one desire, (that of trying to be the best always) we believe we can do quite well for ourselves. That is what we attempt to do in the Core Value portfolio.

With warm regards,

Yours sincerely,

(E A Sundaram)
Chief Investment Officer and Portfolio Manager.

A TRIBUTE

"The true meaning of life is to plant trees under whose shade you do not expect to sit".

R.I.P. Charlie Munger. We have benefitted from the shade that you have provided.

Investment Objective:

The investment objective is to achieve capital appreciation through investment in a diversified portfolio of high-quality companies, purchased at reasonable valuation.

o3 Core Value Investment Approach

Name	GICS Sector	Weight
HDFC Bank Ltd	Financials	7.20%
ITC Ltd	Consumer Staples	5.06%
Infosys Ltd	Information Technology	4.47%
Maruti Suzuki India Ltd	Consumer Discretionary	4.01%
Indraprastha Gas Ltd	Utilities	3.98%
Titan Company Ltd	Consumer Discretionary	3.74%
Bosch Ltd	Consumer Discretionary	3.71%
Divis Laboratories Ltd	Health Care	3.64%
Computer Age Management Services	Industrials	3.48%
Oracle Financial Services Software Ltd	Information Technology	3.42%
		42.71%

Overweight/Underweight of Model Portfolio Compared to Benchmark

Sector	Underweight | Overweight
Industrials	10.11%
Consumer Discretionary	8.30%
Utilities	3.82%
Information Technology	2.72%
Real Estate	2.37%
Health Care	-2.64%
Communication Services	-2.82%
Consumer Staples	-3.03%
Materials	-5.57%
Energy	-7.93%
Financials	-16.34%

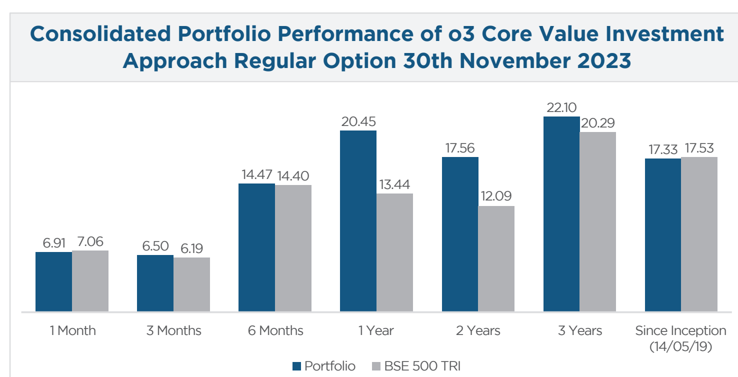
Performance Description	Regular	Concentrated	BSE 500 TRI
Largest Monthly Gain	12.51	11.41	14.63
Largest Monthly Loss	-20.53	-19.19	-23.85
Beta of Portfolio	0.76	0.73	
Standard Deviation (Annualised)	15.40	15.07	
Correlation	0.93	0.91	

- Large Cap: 43.50%
- Midcap: 32%
- Small Cap: 13.50%
- Cash: 11%

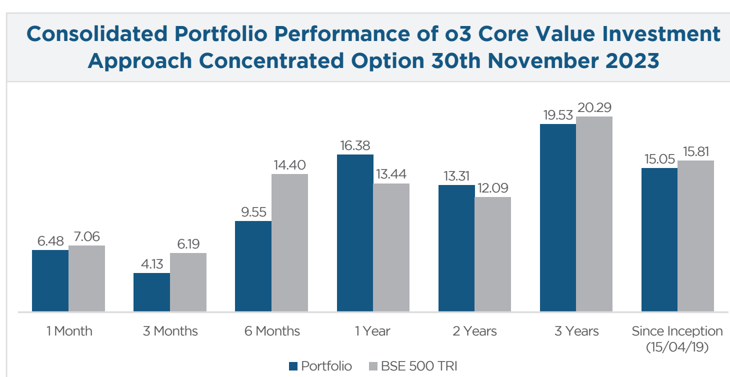
Regular Model Portfolio Composition

Weighted Average ROCE	23.03%
Portfolio PE (1 year forward PE, based on FY25)	25.79
Portfolio Dividend Yield	1.52%
Average Age of companies	54 Years
Overlap with BSE 500 TRI	23.21%
Total Debt/Equity	0.26
Debt/Equity (Excluding Financial Stocks)	0.14
Sales Growth	21.44%
EPS Growth (FY25 over FY23)	16.18%

Consolidated Portfolio Performance of o3 Core Value Investment Approach Regular Option 30th November 2023



Consolidated Portfolio Performance of o3 Core Value Investment Approach Concentrated Option 30th November 2023



- *Benchmark is BSE 500 TRI, the portfolio is spread across different market capitalization, hence BSE 500 TRI is chosen as benchmark.*
- *Since inception date stated is considered to be the date on which the first active client investment was made under the investment approach.*
- *All the above data are as of 30th November 2023. ROCE/ROE are average of last 5 years.*
- *Source: Internal, BSE, Bloomberg & Ace Equity.*

Disclaimer: Performance depicted is based on all the client portfolios existing as on such date, using Time Weighted Rate of Return (TWRR) of each client for the overall investment approach. Past performance is no guarantee of future returns. The above portfolio performance is after charging expenses. The above performance related information provided here is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document. Beta, Standard Deviation & Correlation are from Since Inception period.

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