

Some thoughts at New Year time

Dear Investor,

At the outset, on behalf of o3, I wish you and your family a healthy and joyous New Year 2022.

The turn of the year is a suitable time to look back at some major events during the previous year and list our takeaways from them.

Covid

2021 will be remembered for the impact that the Covid-19 pandemic had on all of us. Too many lives lost, too many person-hours lost, significant impact on the education system, and too many businesses put under pressure. The good news is that at the end of the year 2021, about 1.45 billion Covid vaccinations have happened in India, including six hundred million people who have received the second dose, in addition to about 250 million people who have received one dose. This translates to about 65% of the adult population being doubly vaccinated, and an additional 26% receiving the first dose. From January, the vaccination for those under 18 years is scheduled to start, and the third (booster) dose for healthcare workers and the elderly.

Since March 2020, when the pandemic began to take huge proportions, we, as investors, have been on the lookout for businesses and companies that would be affected less by, and/or would have the ability to recover faster from, the Covid pandemic. At the same time, we stuck to companies that met our required threshold - certain financial characteristics of profitability and cash flows. Done this way, the portfolio was primed to have a good focus on risks, with decent returns.

Skewness within the Index constituents

As portfolio managers, we have never been enamoured just with the Index. The Index is a collection of the stocks with the highest market capitalizations and free float of stocks (depending on which Index one is looking at). The individual constituents of the Index do not move in tandem, and this has important implications for the portfolio manager.

For instance, let us look at the popular Indexes and their performance during 2021:

- The Nifty 50 Index grew by 24.12% during the year 2021.
- During the same period, twenty-four out of 50 Nifty components did worse than the Index itself, and eight of them gave negative returns during 2021.
- The best performing stock of the Nifty 50 during 2021 was Tata Motors, which gave a whopping 162.39% return during the year. Interestingly, the same stock, in its previous 4 years, had delivered a compounded return of -21.76% per annum.
- Amongst the ones that gave negative returns were exceptionally good companies like Kotak Mahindra Bank (-10% return in 2021) and HDFC Life (-3.98% return in 2021), but these stocks had done brilliantly in the previous 4 years prior to 2021. Kotak Bank had given a compounded return of 29.15% per annum and HDFC Life a compounded return of 18.45% per annum during the previous 4 years.

The results are similar in the more broad-based Nifty 500 Index:

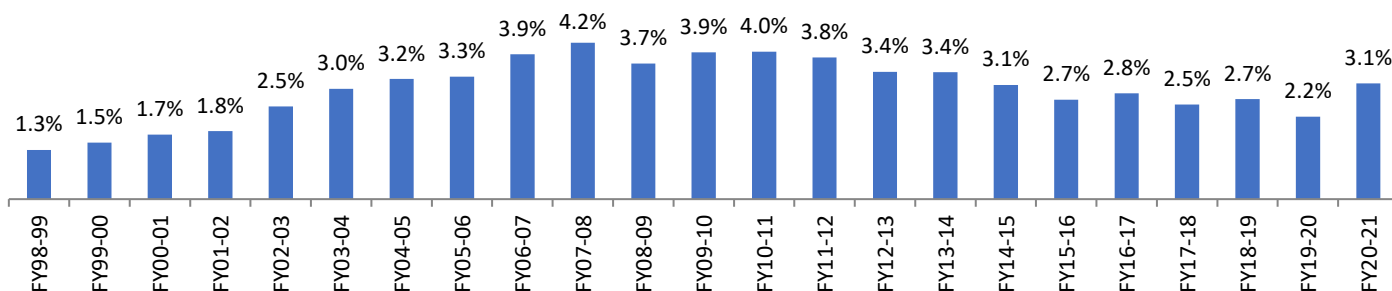
- The Nifty 500 index gave a return of 30.19% during the year 2021.
- Two hundred out of five hundred stocks in the Index underperformed the Index, and there were ninety-three stocks that gave negative returns in 2021.

- The best performing stock in the Nifty 500 during 2021 was Tata Teleservices Ltd with a 2495% return during the year. This stock had given a compounded return of 8.19% per annum during the previous 4 years.
- Amongst the losers were highly regarded companies like Hero Motocorp and Kotak Mahindra Bank that had rewarded shareholders handsomely in the past.

What do we take away from all of these?

- That the market is always cyclical and rewards some companies more generously than others during some times, and vice versa.
- That it makes more sense to consider stocks for investment when they are not very highly valued. We find it more appropriate to look at strong companies when they are NOT having frothy valuations. The chances of disappointment in such cases is less, and therefore the chances of success are higher.

After a long slump, profitability is rising in corporate India - BSE 200 net profits / GDP



Sources: (1) Bloomberg

(2) Economic Survey

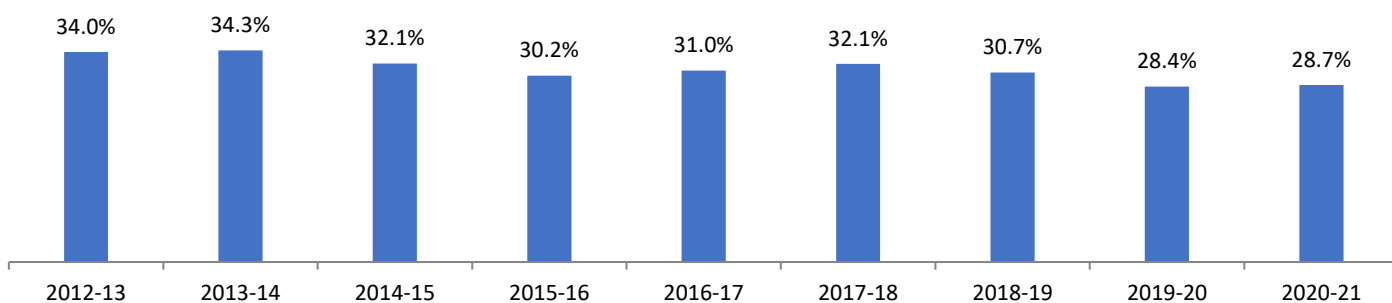
It has been estimated that corporate profits would further rise by about 25% in this fiscal year.

While this figure shows the consolidated profits of the BSE 200 index, it is relevant, while compiling the portfolio, to look at sectors that are (a) expected to do better over the next few years, and (b) where the valuations are not exorbitantly high.

You would have observed that your portfolio is overweight on sectors that now have lower weight in the benchmark indexes. This is our way, i.e., buying into stocks that are not exaggerated too much in terms of their valuations. A low weight in the index signifies lower investor interest, and therefore lower expectations around their stock price movement. If we combine this factor with factors such as improvement in their financial performance over the next few years, and restriction of choices to highly competitive companies, we reach our investment sweet spot.

As an example, let us share one of the main reasons for our being overweight on Industrials in your portfolio.

India - Capital Investment / GDP ratio



Sources: (1) CEIC

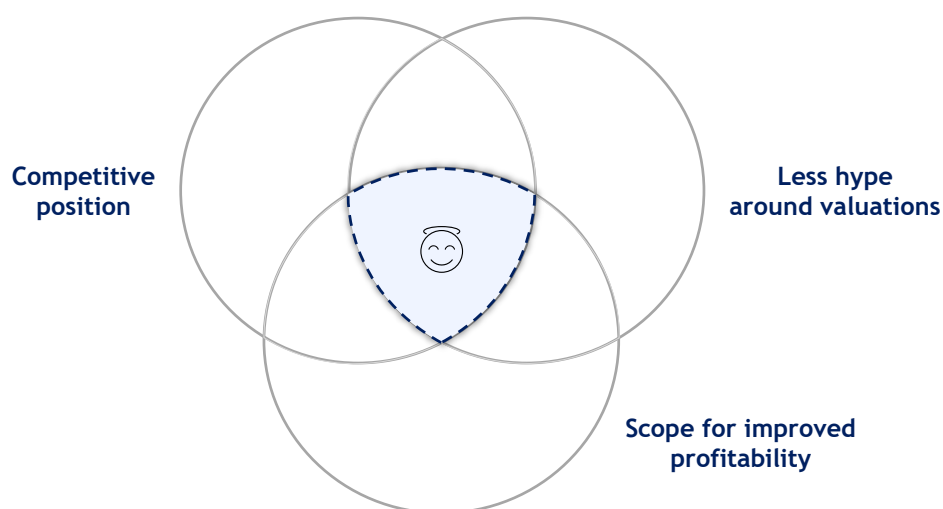
(2) globaleconomy.com

India's capital investment as proportion of GDP has remained in the same range, with lower figures in the immediately past two years. However, there are reasons to believe that it is changing. Apart from the data from the National Infrastructure Pipeline report and the proposed PLI schemes in different industries (data which we had shared in previous newsletters), we are also encouraged by a recent Morgan Stanley report that predicted that capital investment as a proportion of GDP could rise by 6% over the next few years.

We have also seen that Industrials are at amongst the lowest weight in the Nifty in twenty years.

This combination makes way for our investment sweet spot:

- Competitive companies
- Chosen from sectors that have been less hyped in the recent past, and
- Where there is reasonable ground to believe that the performance would significantly improve soon



With Warm Regards,

Yours sincerely,

(E A Sundaram)

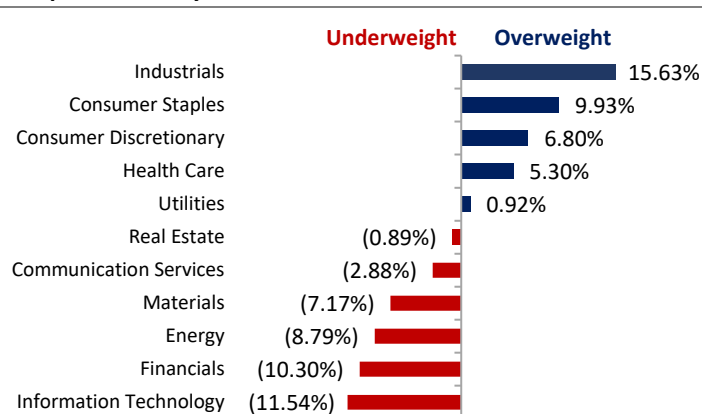
Chief Investment Officer and Portfolio Manager

...Investors pay too much for trendy, fashionable stocks and too little for companies that are out-of-favour, was on the money... Why does this profitability discrepancy persist? Because emotion favours the premium-priced stocks. They are fashionable. They are hot. They make great cocktail party chatter. There is an impressive and growing body of evidence demonstrating that investors and speculators do not necessarily learn from experience. Emotion overrides logic time after time.

- David Dreman

Top 10 Holding of o3 Core Value Investment Approach - Regular Option as on 31st December 2021

Name	GICS Sector	Weight
ITC	Consumer Staples	6.66%
Sanofi India	Health Care	4.76%
Asian Paints Ltd	Materials	4.72%
Bosch Ltd	Consumer Discretionary	4.60%
HDFC Ltd	Financials	4.56%
HDFC Bank	Financials	4.56%
Indraprastha Gas Ltd	Utilities	4.45%
Colgate-Palmolive (India)	Consumer Staples	4.32%
Larsen & Toubro Ltd	Industrials	4.04%
Cummins India	Industrials	4.00%
		46.67%

Overweight / Underweight of Regular Model Portfolio Compared to Nifty 500 as on 31st December 2021


Investment Objective: The investment objective is to achieve capital appreciation through investment in a diversified portfolio of strong businesses, purchased at reasonable valuation.

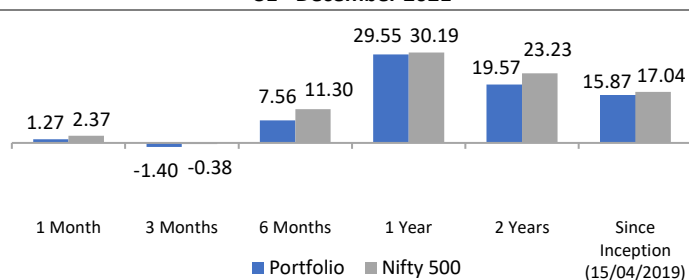
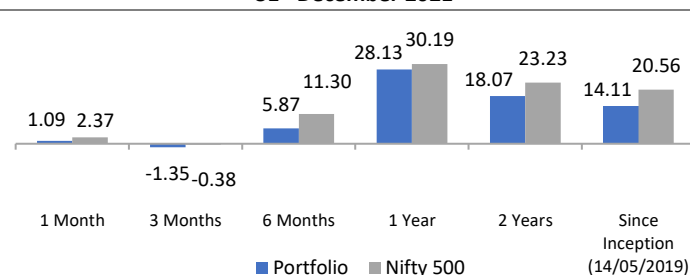
Regular Model Portfolio Details as on 31 st December 2021		Regular Model Portfolio Composition as on 31 st December 2021	
Weighted Average ROCE	24.54%	Large Cap	36.00%
Portfolio PE (1 year forward PE, Based on FY23)	25.66	Midcap	40.00%
Portfolio Dividend Yield	1.72%	Small Cap	21.00%
Average Age of companies	61 Years	Cash	3.00%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order)*
- Midcap: Market cap below 100th company to the market cap of the 250th company in the Nifty 500 (sorted by market cap in descending order)*
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order)*

*As on last working day i.e. 31st December 2021

Regular Model Portfolio Composition as on 31st December 2021

Model Portfolio Overlap with Nifty 500	19.42%	Model Portfolio Overlap with Nifty 50	21.57%
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Consolidated Portfolio Performance of o3 Core Value Investment Approach Concentrated Option 31st December 2021

Consolidated Portfolio Performance of o3 Core Value Investment Approach Regular Option 31st December 2021


- Benchmark is Nifty 500, the portfolio is spread across different market capitalization, hence Nifty 500 is chosen as benchmark
- Since inception date stated is considered to be the date on which the first client investment was made under the investment approach

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 and then computing arithmetic average for the overall strategy. Past performance is no guarantee of future returns. The above portfolio performance is after charging of expenses (Custody Fee adjustment is pending, the performance may change to it for some basis points). The performance related information provided here is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document.

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