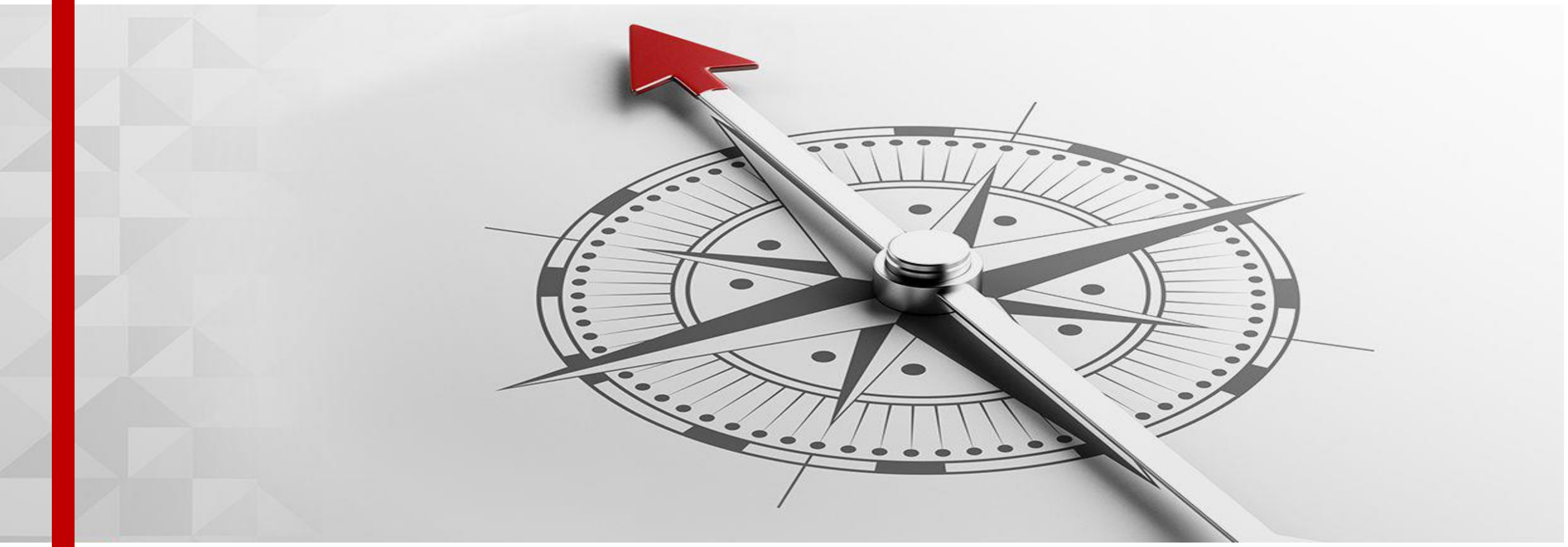
Investor NEWSLETTER



"The perfect is the enemy of the good" - Voltaire

Dear Investor,

You must have observed how amongst many investors, there is a constant endeavour to achieve the "highest" or "best" returns. Investors who, during indifferent market times, claim to be satisfied with a "safe" rate of return that beats inflation, suddenly become dissatisfied with returns even more than 20-25% p.a. during highly bullish times.

Under normal circumstances, there is indeed nothing wrong in this endeavour of trying to be the best. The capital market is the epitome of competitiveness. But circumstances don't always remain normal.

There are times in the market when stocks begin to quote at valuations much higher than historical averages. During such times, it is in our interest to remember the maxim of "**reversion to mean**". The market moves in cycles, and it is vital that we are aware of the stage in the cycle that we find ourselves in. Buying stocks at higher and higher prices, in the anxiety to "maximize returns" and with the belief that the old rules have changed, is a recipe for future heartburn.

We have seen this repeatedly – in 1992, 1999, 2007, 2017 and briefly in 2018 (for bullishness) and in 1995, 2002, 2003, 2008-2009 and 2013 (for bearishness). We have seen single or a combination of sectors do far better than the others in terms of stock prices, and the market participants, in their enthusiasm to "maximize returns" at all points of time, buy more and more of the same sectors at higher and higher prices, believing that they can ride the wave and get out just before it falls. It leads to the inevitable sad result.

This is reflected in the table below. A high weight in an index indicates the higher popularity that sector enjoys at that point. A high weight of the sector also leads many investors, including many institutional investors and of course the index funds and ETFs, to invest more and more in that sector in order to maintain the sector weight in the portfolio.

Nifty 50 Sector Weight

Sector	Dec-99	Dec-02	Dec-07	Dec-12	Dec-17	Nov-19
Auto	5.43	5.60	3.40	8.80	10.63	6.11
Capital Goods	2.12	3.10	10.50	5.90	3.81	3.72
Cement And Cement Products	—	2.40	2.10	4.20	1.60	—
Consumer	16.01	17.90	3.60	12.30	9.20	12.39
Financial Services	8.33	11.70	12.00	29.50	35.03	39.47
Health Care	8.62	8.30	2.20	5.00	4.03	2.15
Media & Entertainment	—	1.20	0.40	—	0.78	0.33
Metals & Mining	3.15	2.90	9.00	3.80	4.54	2.93
Oil & Gas	10.96	17.60	25.40	12.30	12.67	13.26
Others	18.05	0.90	2.30	0.30	1.45	1.31
Technology	20.48	24.20	9.50	11.40	11.39	13.01
Telecommunication	3.36	2.60	11.40	2.00	2.44	1.78
Utilities	0.95	1.60	8.20	4.50	2.41	2.04

Source: NSE website

Notice the changes in the different sector weights over the years. Technology sector was 20.5% of the Nifty 50 in Dec 1999, and it fell to just 9.5% in 2007. Financial services sector was 8.3% of the Nifty 50 in Dec 1999, and is now 39.5%. Oil and gas sector was 25.4% in Dec 2007 and is 13.26% now. These figures are strong indicators of the cyclical nature of the stock market.

Early 2000 was the time of the peak valuations in almost all tech stocks. It was, possibly the worst time to buy Tech stocks. Not just tech, most stocks that were very popular then, did not do well in the years that followed. The subsequent price movement of such stocks proves this.

Change in Market capitalization - From the Tech boom to the Infra Boom (Rs. Crores)

Some Top Stocks on BSE	Feb 2000	Dec 2007	CAGR %	P/E of the stock as on 29/2/2000	5-year avg P/E as on 29/2/2000	Stock's CAGR performance in the previous 3 years ending Feb 2000
Hindustan Unilever Ltd	67,416	47,179	(4.5%)	57.4	44.2	47.5%
Infosys	56,550	101,131	7.7%	210.8	53.8	317.4%
Reliance Industries	31,607	419,043	39.1%	14.1	9.3	31.8%
ITC Ltd	19,952	78,856	19.2%	23.6	28.7	22.5%
Mahanagar Telephone Nigam Ltd	19,117	12,115	(5.7%)	16.2	13.4	6.2%
State Bank of India	13,000	124,793	33.5%	6.1	10.0	(7.2%)
Ranbaxy Laboratories Ltd	11,080	15,874	4.7%	52.4	30.2	41.6%
Larsen & Toubro Ltd	9,568	121,331	38.3%	25.0	15.6	13.7%
NIIT Ltd	9,349	2,582	(15.1%)	48.9	36.6	116.1%
Hindalco Industries Ltd	5,883	26,365	21.1%	15.7	20.9	0.6%
Nestle Ltd	3,336	14,461	20.6%	32.8	45.9	13.8%
Asian Paints	1,504	10,576	28.3%	15.7	20.9	9.5%

Data sources: Bloomberg, ACE Equity and BSE

In Feb 2000 (the peak of the tech boom), the stocks in a few sectors were quoting at valuations well above their historical averages. They had also delivered fantastic returns in the years prior to 2000, and that was one of the primary reasons for continued interest in them. By and large, the stocks that had given extraordinary returns in the previous 3 years (and therefore very popular), and/or the ones trading at valuations well in excess of their long-term averages, performed in a very mediocre fashion in the next few years. On the contrary, stocks that were dubbed as “old economy”, and the ones that were ignored in Feb 2000, and quoting at valuations below, or around their average valuations, did very well in the subsequent years.

Almost entirely this was repeated in 2007, only this time the favoured industries were infrastructure, real estate and power sectors.

Change in market cap from the Infra Boom to the Midcap Boom (Rs. Crores)

Some Top Stocks on BSE	Dec 2007	Jun 2017	CAGR %	P/E of the stock as on 31/12/2007	5-year avg P/E as on 31/12/2007	Stock's CAGR performance in the previous 3 years ending Dec 2007
Reliance Industries Ltd	419,043	448,797	0.7%	23.6	13.5	88.0%
Oil & Natural Gas Corp Ltd	264,568	201,867	(2.8%)	16.1	10.5	31.3%
NTPC Ltd	206,879	130,649	(4.7%)	28.3	16.7	42.0%
Bharti Airtel Ltd	189,100	151,561	(2.3%)	33.1	65.2	66.5%
DLF Ltd	183,082	34,021	(16.2%)	98.1	listed in 2007	listed in 2007
Reliance Communications Ltd	153,846	5,351	(29.8%)	60.5	21.6	36.9% (*)
ICICI Bank Ltd	135,608	186,036	3.4%	33.6	16.8	49.2%
Bharat Heavy Electricals Ltd	126,773	33,128	(13.2%)	46.0	22.9	57.9%
State Bank of India	124,793	236,173	6.9%	13.1	15.2	34.4%
Larsen & Toubro Ltd	121,331	157,542	2.8%	61.2	23.3	48.4%
Hindustan Unilever	47,179	234,108	18.4%	35.0	26.9	14.2%
GlaxoSmithKline Consumer Healthcare	3,094	22,500	23.2%	19.0	17.7	30.9%
Asian Paints	10,576	105,910	27.4%	30.2	23.3	51.0%
Procter & Gamble Hygiene & Healthcare	2,544	26,119	27.8%	22.9	19.1	10.3%

(*) performance for 1 year and 9 months. Data sources: Bloomberg, ACE Equity and BSE

The pattern is clear. Several stocks were purchased in the boom of 2007 **because** they had done well in the previous few years. Scant respect was paid to the high valuations in relation to their long-term average valuations. On the contrary, neglected stocks (provided they were of acceptable quality) that were quoting at reasonable valuations did quite well in the subsequent years. Of course, there would be exceptions to this rule, but the general trend is clear.

What could be the reason for someone to buy a stock at valuations so far above the historical averages? It can only happen when (a) the rule of "reversion to mean" is forgotten, and when investors begin to believe that there is a "new paradigm" that changes the rules completely or (b) the eagerness or anxiety to "outperform" at all times drives people to ignore the valuations.

Exactly the reverse happens in times of extreme bearishness. The bitter experience at the end of the previous bull market makes people averse to the entire stock market and such aversion goes to the extreme, when even good quality stocks, available at very reasonable prices, are shunned because the memory of the bad experience makes people stay away from the stock market as a whole. The years 1994-1995, 2002-03, the latter part of 2008, and 2012-13 were periods marked predominantly by this kind of behaviour.

In theory, all market participants are supposed to be completely rational in their decision making, and information is supposed to be equally available to all participants. But we know that these assumptions aren't true under all circumstances. When the situation is abnormal, trying to be "the best" would mean abandoning rationality ourselves.

Another important point to be remembered is that there is no constancy about who is the best. You would have observed that there is no one who remains at this position for very long. In extraordinarily bullish periods, trying to be the best entails taking significant risks in terms of buying highly expensive stocks, which face the brunt in a downturn. And when the downturn does happen, the hunt is on for a "new best". As investors, our search to remain invested in "the best" leads to frequent churn of our portfolio, and thus increases the cost of investing.

A good way out, dear investor, is to focus on having a "good" portfolio, rather than trying to be "the best". The real advantage that one has with this approach is that one can have several "good" investment products simultaneously, whereas the search for the "best" leaves us with only one ephemeral best.

Howard Marks in his great book "The most important thing" reminds us:

- ***Rule number one:*** most things will prove to be cyclical
- ***Rule number two:*** some of the greatest opportunities for gain and loss come when other people forget rule number one

<u>The takeaways from all of this</u>

1. A low or reasonable entry price is crucial for long-term stock return.
2. A low or reasonable entry price is available only when the stock or sector is not very popular.
3. The level of the index is largely irrelevant for a long-term investor. As we have seen from the tables above, there were individual stocks available at reasonable prices (and those which produced very good returns) even when the rest of the market was at a peak.
4. What matters is **<u>what</u>** we buy, **<u>how much of it</u>** we buy, and **<u>at what price</u>** we buy it.

The focus should be, unendingly, on investing in strong businesses that are available at reasonable prices. The focus should NOT be on "what is going to go up next" or "what will go up the fastest". We also believe that it is in our interest to stick to a style of investing that best suits our temperament, and to diversify our portfolio to products that are managed differently. That way, some of them will be amongst the top performers, while others won't. The sooner we realize that the "underperformers" aren't necessarily worse than the "outperformers" provided the fundamental factors are intact, we won't do too badly for ourselves.

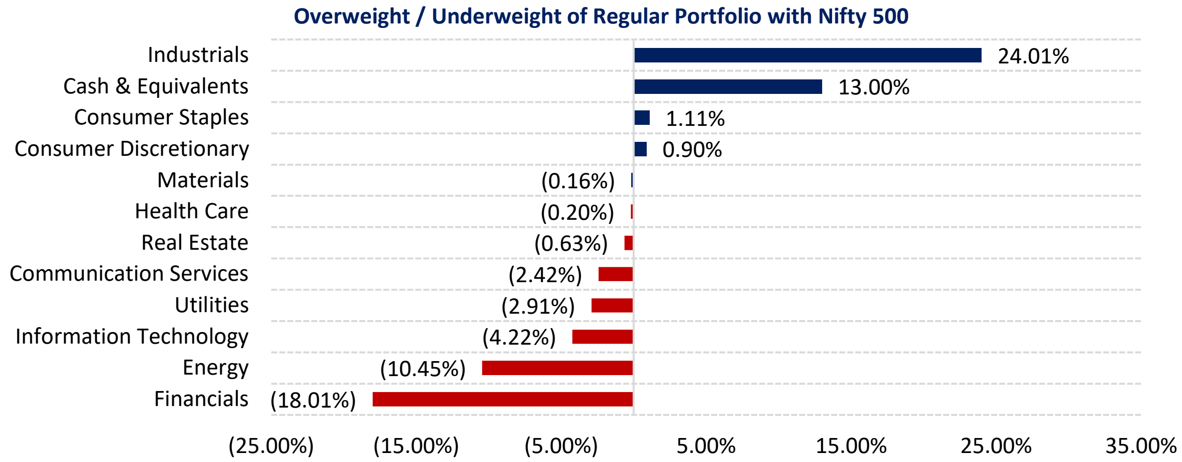
By the way, that is just what we attempt to do with your portfolio.

Warm regards,

Yours sincerely,

(E A Sundaram)
Chief Investment Officer and Portfolio Manager

Over/Under Weight of Model Portfolio Compared to Nifty 500 as on 29th November 2019



Model Portfolio Details as on 29th November 2019		Model Portfolio Composition as on 29th November 2019	
Weighted Average ROCE	29.88%	Large Cap	35.0%
Portfolio PE (1 year forward PE, Based on FY21)	18.94	Midcap	38.0%
Portfolio Dividend Yield	1.44%	Small Cap	14.0%
Average Age of companies	62 Years	Cash	13.0%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 29th November 2019
- 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) as on 29th November 2019
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 29th November 2019

Model Portfolio Composition as on 29th November 2019	
Model Portfolio Over Lap with Nifty 500	14.61%
Model Portfolio Over Lap with Nifty 50	11.40%

Consolidated Portfolio Performance of Core Value Concentrated Strategy		
Period	29th November 2019	
	Portfolio	Nifty 500
1 Months	(0.33)	2.24
3 Months	10.92	10.19
6 Months	5.04	0.58
Since Inception (15/04/2019)	6.15	1.44

Consolidated Portfolio Performance of Core Value Regular Strategy		
Period	29th November 2019	
	Portfolio	Nifty 500
1 Months	(0.50)	2.24
3 Months	10.98	10.19
6 Months	3.39	0.58
Since Inception (14/05/2019)	7.58	7.14

- Since inception date stated is considered to be the date on which the first client investment was made under the strategy

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.