

The power of the ordinary

Dear Investor,

Remember the film “3 Idiots”? In this delightful 2009 movie by Rajkumar Hirani, there is a scene in which students are asked to explain what a machine is. The definition accepted by the Professor is a long-winded, textbook definition of what a machine is, while the character played by Aamir Khan, simply defines a machine as “anything that reduces human effort.”

This one line encapsulated the essence of all that was mentioned in the lengthy definition (which nobody except a few engineers would have probably understood) given by the “star” student. This scene is also a classic example of the sadly prevalent tendency to unnecessarily complicate something that can be explained in very simple terms.

Something similar happens in the stock market all the time. Some of us seem to have the uncanny ability to complicate matters with high-sounding jargon, where none is really necessary.

I am sure you have noticed the fanciful descriptions in many cases, and attempts made to entice investors with a language where the adjectives outweigh the fundamentals.

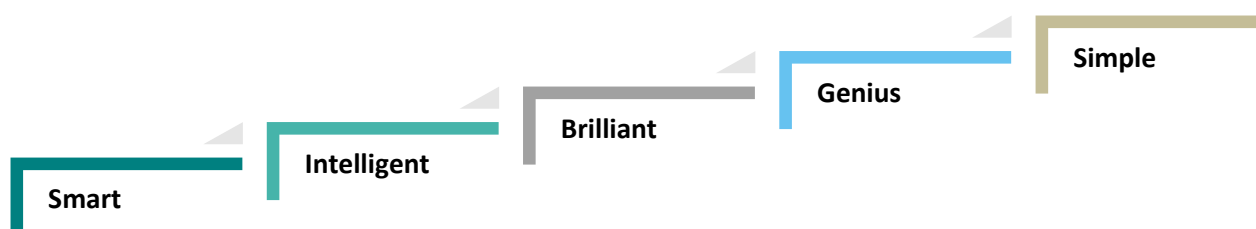
The point is, there is really no correlation between the complexity of the business (or the revolutionary nature of its product/services) and the returns it generates for the investor.

Let’s think of a multiple-choice competitive exam. The sequence of questions in several of these exams is intelligently framed. There are easy questions, and difficult questions. Sometimes, a series of difficult questions would be bunched together. The skill of the student is tested in not only answering the questions, but also in deciding which ones to attempt and which to pass over. The smart student would skip over, without panic, all the questions that, in his/her judgement, cannot be solved within a minute or so, and concentrate on completing all the questions that are simple to him/her. And later, when time permits, come back to attempt the more difficult ones. The important point is that the easy questions and difficult questions carry the same marks. So, like the competitive exam, an investor can make a decent amount of money in simple businesses, but unlike a competitive exam, there is no time limit. We can choose our investments at the time of our choice.

Now, the stock market is really not a place where we need to prove our intelligence or have an assessment of all the factors that cause the stock prices to rise or fall. What we need is enough sense to spot a good business and wait for it to become available at a good price. We also need the temperament to skip over things that we do not understand, or the ones that we find too expensive. And yes, we can make decent money in simple businesses.

Our intention in this Newsletter is to give our reasons why we think the simple stuff, or the “ordinary stuff” is extremely important while creating our investment program. And these are well within the reach of all of us, including those without any fancy degrees, and including those who do not have the ability to talk glibly about all topics under the sun.

It is said that Albert Einstein gave this hierarchy (in ascending order) of cognitive prowess:



We think this is extremely important because investing is not just about studying economic trends, corporate profitability, and technological changes. Equally importantly, investing is also about studying ourselves. Since our money is involved, we have to make sure that our money goes into businesses that we understand to at least a reasonable degree.

The relevant point here is that businesses that “sound very intelligent” do not necessarily give higher returns. Please take a look at these charts:

Chart 1 - 1-year returns generated by various sectoral indexes

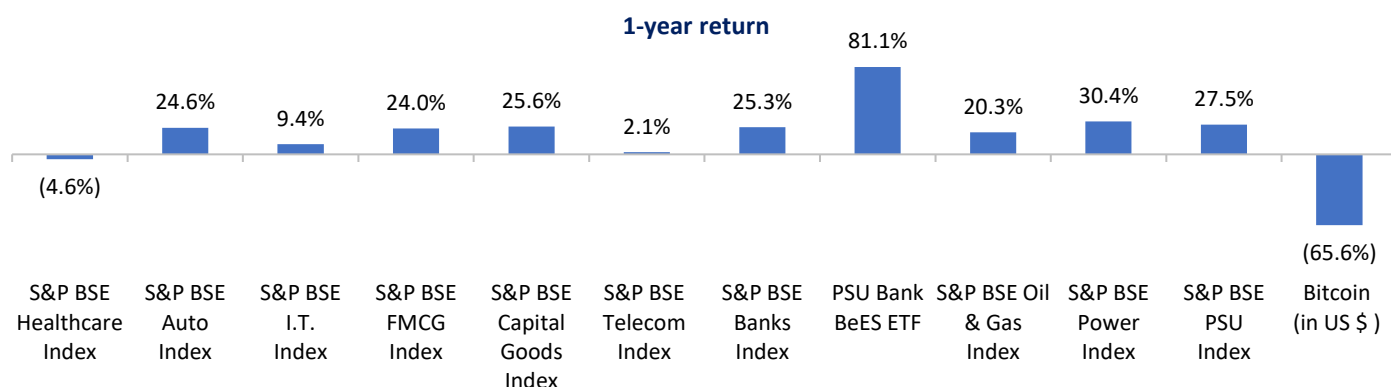
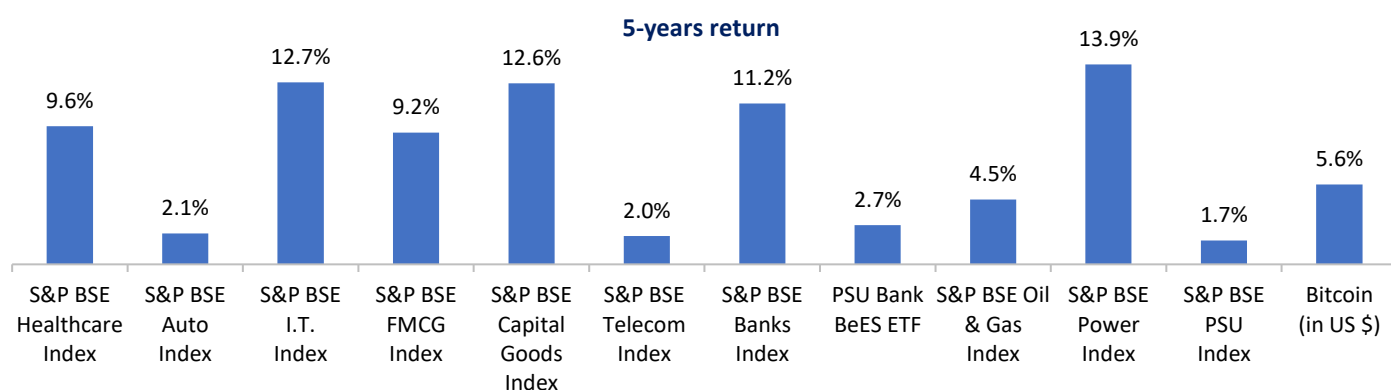


Chart 2 – 5-year CAGR returns generated by various sectoral indexes



Note: Data compiled as on 21st December 2022.

As can be seen from the charts, some perfectly “ordinary” businesses have also given good investment returns. You would remember that until about a year ago, the PSU Bank stocks were completely ignored and ridiculed. In the last one year, the PSU Bank ETF has generated 81.1% returns, only proving our point that businesses that are dismissed as “ordinary” are capable of generating very decent returns indeed. And it is possible to lose money in something that just a year ago, was described as “the future of money.”

Consider the following points:

The price movement of a stock is a function of literally thousands of variables. These include:

- Company-specific variables
- Quality of people running the company
- Growth prospects
- Extent of competition in the business, both from other companies as well as from substitute products or services
- Technological changes in the industry
- Fiscal changes

- Macroeconomic factors
- Political and geopolitical trends
- Natural factors
- Other man-made factors like war etc.
- Special events like the pandemic that affected us for nearly 2 years and still troubling several parts of the world
- The list goes on....

After all of these things, the price movement of stocks is also affected by how thousands of market participants, each with a different mandate and more importantly, different time horizons, are viewing each of these same events. These participants include institutional buyers, sovereign wealth funds, pension funds, insurance companies, hedge funds, quantitative traders, chart-based traders, long-short participants, momentum traders, long-only investors and many more. Some of these people have time horizons of years, and others have a time horizon of just a few hours.

Given the sheer number of variables to contend with, we have concluded that attempting to predict the price movement of stocks is something that we will not do, **but more importantly, WE ARE NOT WORSE OFF BECAUSE OF THIS.**

This is the method that we have found suitable:

- Just stick to businesses that we, with a reasonable amount of diligence, can understand.
- From such a set of businesses, choose companies that have the ability to compete effectively in the marketplace.
- Buy such companies when the level of expectations around them is not too high to begin with.

We have seen repeatedly in the past that there are times when the expectation level around a stock is simply too high. Highly bullish reports about the prospects of the company or industry, sharp shorter-term profit growth that fuels participants' interest in the stock, lead to very high levels of expectations, and this is reflected in the valuations of the stock.

Higher level of expectations means higher chances of disappointment.

These points have nothing to do with the quality of the companies being talked about, or about their future prospects. It is just more prudent to avoid companies where the market price reflects ALL the good things about the company. Essentially, we are saying that we have to buy a good business before the general investment population agrees that it is a good business to invest in.

- In 1999-2000, there was nothing wrong with the IT business. It is just that too many expectations were generated around it.
- The same thing happened to Real Estate, Infrastructure and Power business in 2007.
- Mid-cap and Small-cap stocks in 2016-17.
- NBFC and Housing Finance companies in 2018.
- It also happens to individual companies several times.

Two other important points in any investment program:

It pains us to see that the following two points that are vital to generating a decent return are ignored in almost all public discourses about the stock market. We urge you to consider these carefully:

- a) Keeping cost of investing low, and
- b) Not being bothered too much about how much money someone else has made.

We cannot overstate the importance of these two points.

Investment returns are not just a function of how much we make. They are also a function of how less we lose. Costs increase as a result of (i) heavy churn in the portfolio (ii) buying at any price (iii) exorbitant fees paid.

The root cause of churn, in many cases, is the desire to have the “highest return,” and this leads us to making expensive mistakes. We have repeatedly stated in our previous newsletters that there is no investment product that sustainably remains in the No.1 position. What makes sense, is to choose 4 or 5 “good” products that are different from one another and abandoning the search for the elusive “best”.

Dear Investor, we submit that our success in the market is a function of realizing that there are several things beyond our control, but there are a few things within our control.

- What we buy
- How much of it we buy
- At what price we buy
- How we respond to the behaviour displayed by the others in the market

These four things are very much within our control and should ideally play a greater role in our investment program.

It is worthwhile to remember Benjamin Graham’s sage advice: ***“To achieve satisfactory investment results is easier than most people realize; to achieve superior results is harder than it looks.”*** While it is perfectly legitimate to attempt to earn a good return from investments, the key is to not increase the risk levels in the search of superior returns. This key lies in our hands.

The New Year is almost here. On behalf of o3, I wish you and your family continued good health, prosperity, and joy in the ensuing New Year 2023.

Happy New Year!!

Warm regards

Yours sincerely,

E A Sundaram

Chief Investment Officer and Portfolio Manager

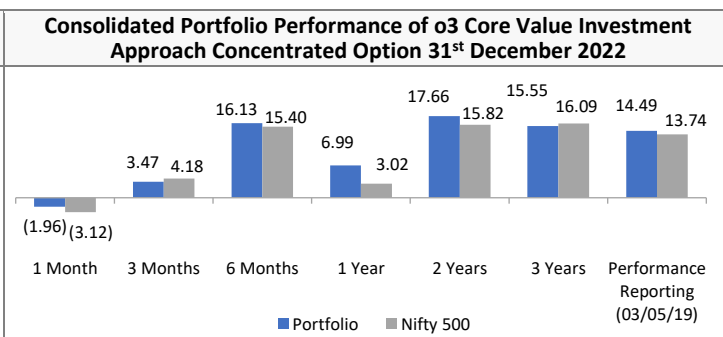
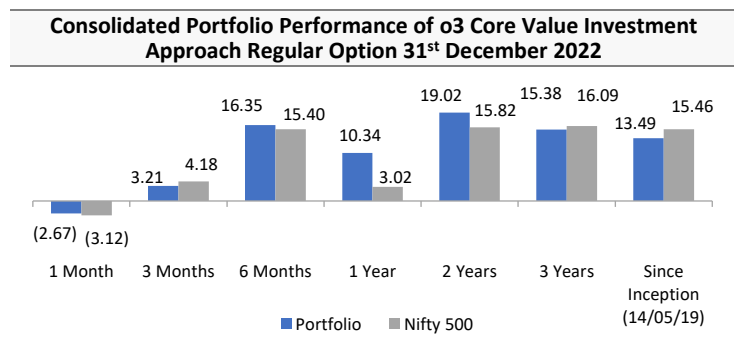
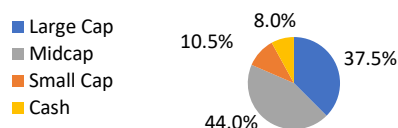
“Excellence is doing ordinary things extraordinarily well”

- John W Gardner

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			Regular Model Portfolio Data	
Name	GICS Sector	Weight	Underweight	Overweight
ITC	Consumer Staples	6.62%		10.29%
HDFC Ltd	Financials	5.56%		6.88%
Indraprastha Gas Ltd	Utilities	5.25%		3.38%
Bosch Ltd	Consumer Discretionary	4.57%		2.04%
Asian Paints Ltd	Materials	4.25%		1.58%
Titan Company Ltd	Consumer Discretionary	4.12%		
Larsen & Toubro Ltd	Industrials	3.90%		
Sun Pharmaceutical	Health Care	3.61%		
Honeywell Automation	Information Technology	3.55%		
MCX	Financials	3.51%		
		44.94%		
			Utilities (0.38%)	
			Real Estate (0.80%)	
			Communication Services (2.77%)	
			Materials (6.36%)	
			Energy (9.08%)	
			Financials (12.78%)	

Performance Description	Regular	Concentrated	Nifty 500	Regular Model Portfolio Composition	
Largest Monthly Gain	12.51	11.41	14.52	Weighted Average ROCE	21.90%
Largest Monthly Loss	(20.53)	(19.19)	(24.25)	Portfolio PE (1 year forward PE, based on FY24)	26.71
Beta of Portfolio	0.76	0.74		Portfolio Dividend Yield	1.54%
Standard Deviation (Annualised)	16.77	16.35		Average Age of companies	59 Years
Correlation	0.93	0.92		Overlap with Nifty 500	19.29%
				Total Debt/Equity	0.41
				Debt/Equity (Excluding Financial Stocks)	0.09
				Sales Growth	18.47%
				EPS Growth (FY24 over FY22)	24.46%



- 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 active client investment was made under the investment approach
- Industry Classification as recommended by AMFI, all the above data are as of 30th December 2022

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 investment approach. Past performance is no guarantee of future returns. The above portfolio performance is after charging of expenses. 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. Beta, Standard Deviation & Correlation are from Since Inception/Performance reporting period.

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