June 2019

Investor NEWSLETTER

"Getting it right" versus "Not getting it wrong"

The difference between glamour and common sense

Dear Investor,

Of all the die-hard habits in stock market investing, the most persistent is perhaps the desire to "predict" the future. Predictions are routinely made about which sector or stock is going to outperform (and by how much), about earnings estimates (sometimes stretching to over two or three years into the future), and they extend to predictions about industry trends, political trends, election results (and their impact on stock prices), interest rates, currency movements, commodity price movements. It also extends to the impact that geo-political events would have on the stock market, and how major central banks would move their interest rates.

Let's forget for a moment the track record of accuracy of such predictions, and instead think about what it takes to "getting it right" in terms of predictions.

An analyst who tries to predict the earnings trajectory of a company (let us assume it is a reasonably large company with a diversified product base), must get the following things right:

- Sales trajectories of each of their divisions
- The impact of competing products on the sales and profits of this company's products
- Arrive at precise margin profiles for different segments (bearing in mind that companies don't give out such precise data)

Even if the analysis is done with such millimetric precision and the estimates turn out to be accurate, there is still a question of "how much of this was already anticipated" by the rest of the market.

The stock market usually is willing to pay more for companies that "beat the estimates", which means that companies that have done this with greater consistency tend to get purchased at valuations that are, in several instances, exorbitant. But so long as the investment community thinks that the earnings "momentum" can be maintained, the stock gets peddled at higher and higher prices.

The stock market is nothing if not a leveller of expectations. When such high expectations are there from stocks, it usually means that the prices at which such stocks are quoting are enormously high. And when the company's performance does not "beat expectations" (which in many cases, are already too high), or worse, when it "fails to meet expectations" the stock comes hurtling down, leading to sharp loss for the investor.

There have been too many such instances over the past several years for us to enumerate some of them.

But this is not the point we are interested in making. The point is, this whole process is dependent on "getting it right" – getting the earnings trajectory right (not just that, the earnings of the respective companies have to be better than what the market as a whole expects it to be, and in case we didn't mention it earlier, the expectations keep rising with each quarter of meeting the earlier expectations). And finally, the investor in this method expects to correctly predict an earnings figure that is better than the consensus predicted by an equally intelligent set of people, using the same information that is available to the same set of equally intelligent people.

In our humble opinion, this whole exercise is fraught with too many assumptions about the individual's ability to out-analyse the rest of the market.

There is another way. A way that is capable of producing very acceptable levels of results.

Not getting it wrong (i.e., avoiding the serious mistakes)

As an equity investor, what is the most important risk that one contends with?

Without any doubt, it is the risk of permanently losing money. Short term fluctuations would always be there and would affect any stock in the world. But permanent loss of capital is probably the single most important risk that we must try to mitigate.

Permanent loss of capital has a greater chance of occurring when

(a) Investments are made in businesses where the fundamentals are weak and/or deteriorating

(b) Investment are made in companies run by persons who are either incompetent, or dishonest, or both

(c) Investments are made at exorbitant prices.

As investors, we have a lower chance of failure when we stay away from such investments, or in other words, by not getting it wrong, we have a better chance of succeeding.

In the three points enumerated above, points (a) and (b) are similar to what most people are trying to do. No serious investor wants to buy into a weak business, or into a business where the management is suspect, but it is this tendency to pay a premium for "beating expectations" that causes serious downturns in stock prices, the moment the expectations are not met.

Our method of avoiding mistakes seeks to invest in companies when the level of expectations isn't too high to begin with. Now, when does a good company with good management come to a price when there is a low level of expectation around its future performance? That happens only when there is a market consensus that expresses apprehensions about the immediate growth prospects of such a company.

So long as there is nothing wrong with the company's long-term ability to compete, a short term problem gives us an opportunity to buy into it at a reasonable price, thanks to the obsession of a great many number of people in the market for "getting it right all the time" and who tend to ignore such good companies when they don't show a promise of immediately "beating expectations".

Since there is a lower level of expectation around this stock, there is also a lower chance of disappointment, and therefore a greater chance of capital appreciation. Although by no means is success guaranteed under either method, this method of "avoiding the big mistakes" appeals to us.

By the way, this method also has far less competition than the method that tries to "get it right" all the time!

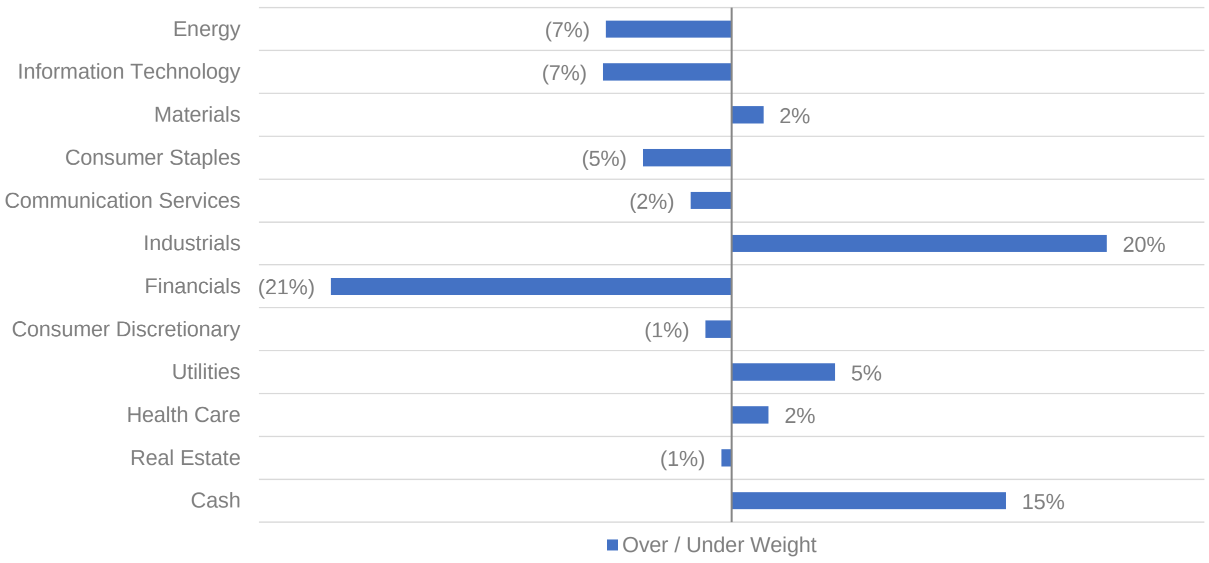
Warm regards,

Yours sincerely,

(E A Sundaram)
Portfolio Manager & CIO

> "Respect the difficulty of working with a mass of information. Few of us can use it successfully. In-depth information does not translate into in-depth profits"
>
> *David Dreman*

Over/Under weight of Portfolio compared to Nifty 500



Model Portfolio Details as on 31st May 2019

Weighted Average ROCE	30.31%
Portfolio PE (1 year forward PE, Based on FY 20)	20.46
Portfolio Dividend Yield	1.31%
Average Age of companies	54 Years

Model Portfolio Composition as on 31st May 2019

Large Cap	42.50%
Midcap	33.00%
Small Cap	11.50%
Cash	13.00%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on May 31st, 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 May 31st, 2019
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on May 31st, 2019

Model Portfolio Composition as on 31st May 2019

Model Portfolio Over Lap with Nifty 500	14.16%
Model Portfolio Over Lap with Nifty 50	15.28%

Disclaimers and risk factors: o3 Securities Private Limited is registered with SEBI as Portfolio Manager under SEBI (Portfolio Managers) Regulations, 1993. This Document is for information purpose only. None of the material on this document and/or on website is intended to be a recommendation to buy or sell any financial product including distribution, an endorsement, an investment advice, an offer to buy or sell or the solicitation of an offer to buy or sell any securities/ schemes or any other financial products/investment products (collectively "Products"). None of the material on this document and/or on website is intended to be tax advice.

Any use of the information contained herein for investment related decisions by the Investors/ Recipients is at their sole discretion & risk. Please read the Disclosure Document and the agreement along with the related documents carefully before investing.

Investments in Products are subject to market risks, various micro and macro factors and forces affecting the capital markets and include price fluctuation risks. There is no assurance or guarantee/ warranty that the objectives of any of the Products will be achieved. The investments may not be suited to all categories of Investors/ Recipients. Investors/ Recipients must make their own investment decisions based on their own specific investment objectives, their financial position and using such independent professional advisors, as they believe necessary, before investing in such Products. While o3 Securities Private Limited shall endeavour to update on a reasonable basis the information disclosed here, o3 Securities Private Limited does not undertake to update such information to reflect the impact of circumstances or events, including regulatory or compliance changes that arise after the date of these disclosures. Past Performance is not indicative of future returns.

This document is strictly confidential and meant for private & restricted circulation only and should not at any point of time be construed to be an invitation for subscribing to o3 Securities Core Value Concentrated Strategy and/or Core Value Regular Strategy. This document may not be reproduced or redistributed to any other person. The document is solely for the understanding of intended recipient and if you are not the intended recipient, you are hereby notified that any use, distribution, reproduction or any action taken or omitted to be taken in reliance upon the same is prohibited and may be unlawful. This document has neither been approved nor disapproved by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document. This document is not for public distribution.