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Invest

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"All the art of living lies in a fine mingling of letting go and holding on". **– Henry Havelock Ellis**

Dear Investor,

In this month's newsletter, I wish to share with you some thoughts about constructing and maintaining a portfolio. These are learnings gained in over 3 decades of my career in investing. These need not be the same with all investors or portfolio managers.

The primary factors

The factors to be always kept in mind while constructing the portfolio are:

- The future is always uncertain. We can try and obtain as much information as we can about the businesses we choose to invest in, but the information will always remain incomplete.
- Our intention is to profit from our investments.
- Our intention is also to not lose money permanently.

Almost all of portfolio management is in getting these three points in balance.

Handling an uncertain future

However much we try to take comfort from past patterns and extrapolating them into the future, the fact is that we do not know what tomorrow has in store for us. There are simply too many variables at play in the stock market, and the least that we can do is to avoid kidding ourselves that we have mastered all those variables. We have not, and never will.

So how do we go about it? As they say, the first thing about any journey is to determine where we are, and where we want to reach.

What to buy?

Determining where we are (i.e., what sort of temperament we have) is crucial in this decision. Our portfolio should always be in sync with our ability to handle risk (defined as the chance of losing money permanently). If investing is about a journey into the realms of the unknown, isn't it better to undertake the journey with strong companions? Therefore, we see merit in restricting the choice of companies to highly competitive companies with a proven track record. The prospects of a company are very important but giving more importance to "what could be" while forgetting "what is" has led many investors up the garden path. It is an avoidable mistake.

At what price to buy?

After careful consideration (aided by some hard knocks on the way) we have concluded that it is safer to buy the shares of companies that are away from the limelight in terms of excessive publicity or hype. Hype means high levels of optimism around the company's prospects. Higher optimism means higher valuation. Higher optimism also means less ability of the stock to satisfy the expectation of the investment community. The satisfaction derived from our investments is inversely proportional to the extent of optimism about the stock prevalent at the time of its purchase.

I have derived great inspiration from the book "Contrarian Investment Strategies – the next generation" by David Dreman. I would like to share one of the great quotes from the book:

"Positive surprises result in major appreciation for out-of-favour stocks, while having minimal impact on favourites. Negative surprises result in major drops in the price of favourites, while having virtually no impact on out-of-favour stocks"

	These lines are so important. Any stock, however good the underlying company may be, would find it very difficult to fulfil the expectations around it, if the level of expectations is too high. And the valuation of the stock is a good indicator of the level of expectation around it. We have found it sensible to stay away from excessively hyped stocks. It is a good way to avoid losing money permanently.
Spreading the risk	I have observed people say and have also read that the great Warren Buffett did not believe too much in diversification. It has also been pointed out to me that Buffett believed in large, concentrated bets. My response to such comments has been the following: (1) We are no Warren Buffett, and (2) We do not have an unlimited waiting period (although our waiting period is relatively longer than that of most mainline investment products in the country) We do not agree that a 5 stock or 6-stock portfolio would be suitable for a great majority of investors. We believe that adequate (but not excessive) diversification is in the interest of the investor. We have concluded that 25 is a good number to have. Within the portfolio, we try and ensure the following: • Not more than 10% in any single stock. • Not more than 30% in any single sector. • At least 4 non-correlated sectors in the portfolio All of these are manifestations of our belief that a portfolio is not merely a collection of our "best investment ideas". No better example of this can be found apart from the experience of 1999-2000 during the now famous "Tech boom". Several people went overboard with the idea of a "new economy" and some portfolios had 95% weight in the popular sectors of the day. A portfolio, apart from having good investment ideas, should also provide a suitable balance between the desire to earn a decent return and the protection against a sharp downturn. The two aspects that we spoke about (a) staying away from excessive hype and (b) adequate diversification are means to achieving these ends.
For how long will we hold the stocks?	We would like to hold on to our stocks until these conditions remain satisfied: (a) The original assumptions with which the stock was purchased in the first place are still valid. (b) The stock has not run up too much, i.e., well beyond 2 standard deviations from its long-term average valuations, or well beyond its estimated growth rate in earnings, or well beyond its estimated intrinsic value based on discounted cash flow calculations. (c) There is not a superior investment opportunity that has been spotted yet; or (d) There is no redemption request from the client, either fully or partially. Using these parameters, we have kept our portfolio churn rate at amongst the lowest in the industry.
Periodic pruning of positions	What if a stock runs up in price, but is still considered good enough to be in the portfolio? We regularly check the portfolio for such cases and adopt a system of pruning the positions to make them consistent with the model portfolio. This is important from the point of view of not going overboard with a single idea, as we had explained in the previous segment. This is the reason that you may see some churn in your portfolios.

How much to buy?	While we do not buy more than 10% of the portfolio in each stock, determining which ones have a higher weight than the others is a function of the following: (1) The judgement about the extent of sustainable competitiveness displayed by the company, and a judgement about its future growth prospects. (2) The attractiveness of the stock in terms of its valuation, and therefore the potential for future appreciation (3) The extent of liquidity the stock displays on an average. If there are two companies with strong balance sheets and equally good valuations, the stock that has a higher volume of liquidity would get a higher weightage. As a thumb rule, we try and ensure that we hold no stock in the portfolio where we are not confident of completely selling the entire holding within 4-5 trading days (based on the average traded volumes and our own intended position)

Dear Investor, we have given these details to you as we thought it was important for you to understand the thought process behind our method of portfolio construction. In this era of 24*7 business channels and social media, where the "identification of new investment ideas" seems to take precedence over everything else, these details may sound like drudgery for some, but what seems boring is almost always invaluable.

Warm regards,

Yours sincerely,

(E A Sundaram)
Chief Investment Officer and Portfolio Manager

Top 10 Holding of o3 Core Value Investment Approach - Regular Option as on 28th February 2021

Name	GICS Sector	Weight
ITC	Consumer Staples	6.36%
Oracle Financial Services Software	Information Tech	5.47%
Colgate-Palmolive (India)	Consumer Staples	5.07%
Container Corporation of India	Industrials	4.82%
Cummins India Ltd	Industrials	4.79%
Asian Paints Ltd	Materials	4.42%
Sanofi India	Health Care	4.31%
HDFC Bank	Financials	4.28%
Bosch	Consumer Discre	3.92%
State Bank of India	Financials	3.87%
		47.31%

Overweight / Underweight of Regular Model Portfolio Compared to Nifty 500 as on 28th February 2021

Sector	Underweight	Overweight
Consumer Staples		10.33%
Industrials		7.48%
Health Care		6.11%
Consumer Discretionary		2.05%
Materials	(0.61%)	
Real Estate	(0.67%)	
Information Technology	(2.01%)	
Communication Services	(2.85%)	
Utilities	(3.21%)	
Energy	(9.43%)	
Financials	(15.18%)	

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

Regular Model Portfolio Details as on 28th February 2021	
Weighted Average ROCE	29.43%
Portfolio PE (1 year forward PE, Based on FY22)	27.68
Portfolio Dividend Yield	1.89%
Average Age of companies	63 Years

Regular Model Portfolio Composition as on 28th February 2021	
Large Cap	40.0%
Midcap	37.5%
Small Cap	14.5%
Cash	8.0%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 26th February 2021
- 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 26th February 2021
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 26th February 2021

Regular Model Portfolio Composition as on 28th February 2021	
Model Portfolio Overlap with Nifty 500	13.33%
Model Portfolio Overlap with Nifty 50	15.56%

Consolidated Portfolio Performance of o3 Core Value Investment Approach Concentrated Option

Period	26th February 2021	
	Portfolio	Nifty 500
1 Months	6.48	3.73
3 Months	16.10	14.12
6 Months	26.91	27.33
1 Year	23.33	26.59
Since Inception (15/04/2019)	11.41	12.43

Consolidated Portfolio Performance of o3 Core Value Investment Approach Regular Option

Period	26th February 2021	
	Portfolio	Nifty 500
1 Months	4.94	3.73
3 Months	12.96	14.12
6 Months	20.67	27.33
1 Year	19.7	26.59
Since Inception (14/05/2019)	13.31	17.23

- 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. *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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