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# Investor NEWSLETTER

## Some lessons that hopefully we will learn from the Covid19-induced problem

Dear Investor,

We have completed more than a month of the lockdown, which, although economically debilitating, has succeeded greatly in reducing the number of casualties. It is natural that for many governments, reducing the death count is priority No.1, and on this point, India has done much better than many other countries.

Of course, the lockdown cannot extend indefinitely. As we write this newsletter on 1st May, it is increasingly clear that the lockdown will not be lifted across the country on 3rd May. Regions affected more than proportionately (i.e., the "red" zones) will have an extension of the lockdown, while the "green" and "orange" zones are likely to see relaxations.

There is no doubt that the last two months have changed our country and our world. All the GDP growth projections have been sharply revised downwards. Moody's have, in their latest estimate, revised India's GDP growth rate in FY 2020-21 to 0.2%. Only last month, the same organization had estimated the growth for FY 2020-21 to be at 2.5%.

Several industries will be very badly affected. Most notably those linked to travel and tourism, automobiles, construction, engineering etc. Banks that have lent to these industries, as well as to the badly affected SME segment, will also see significant impact.

At the same time, there are other industries/businesses where the impact would not be so negative. Companies engaged in pharmaceuticals (especially those in chronic therapies), food and personal product related companies and utilities would be much less affected. We had, in our last newsletter, explained to you our approach to constructing your portfolio. There is no significant change in our approach.

In the last one month, there haven't been any major change in our portfolio. You would recall that we had utilized a great deal of the cash reserves to buy shares of good businesses, when the markets had sharply fallen in March. But, after a decent rise in April, we have pruned our holdings slightly in HDFC Bank, Sun Pharma, Sanofi and Sundaram Finance and increased the cash holding slightly.

### Lessons from these difficult times

Any difficult time brings out new lessons. We believe that we would emerge stronger from this ordeal if we learn from these experiences and alter our ways of doing things.

a. Increased focus on personal hygiene. We sincerely hope that even after the lockdown lifts, and indeed even after the fear and apprehension of the Covid-19 fades into a distant memory (and we hope it happens soon), we don't lose the increased sense of personal hygiene that we have become aware of now.

b. Increased use of digital tools. Our way of greeting and meeting people might change quite permanently after this event. Over the last month and a half, we have had increasingly frequent meetings over videoconferencing and web-seminars, and we have found out that they don't really take away the efficacy of the meeting to that extent. Also, greeting people with a traditional "namaste" might replace the western handshake during physical meetings, whenever they are held.

c. <u>While investing, focus on risk control, and not just on the returns</u>. It is not just during times like these, but AT ALL TIMES, we as investors should realize that managing a portfolio is more about managing the risk. Returns are a by-product of a good investment process that attempts to minimize risk to the extent possible. Too many times, the investment community has been enamoured with the investment product that has delivered the "highest" return, whether it is equity or fixed income. While competition to generate the highest return is good until a point, beyond a reasonable limit it becomes a dangerous game, where risk is forgotten. We can't improve upon Warren Buffett's immortal quote on this subject – **"only when the tide goes out you realize who has been swimming naked"**.

d. <u>Understand the rotational nature of investment products</u>. If we don't attempt to invest in the No.1 investment product, what is the alternative? The sensible thing, in our opinion, is to be aware that there is NO investment product that is constantly at the top. It is a style that is temporarily at the top, and investment products that have been using that style aggressively at that particular point in time seem to be invincible. But that is not permanent. Haven't we seen the following?

- In 1999, products that were heavily overweight on Technology sectors briefly shone very brightly, but after the peaking out of the Tech sector in 2000, they faded away.
- In 2007, products that were overweight in Real estate, power and infrastructure shone very brightly indeed. In the next several years, such products did not do well.
- In 2016-17, there was such a frenzy about mid and small cap stocks and products that invested in them. Ironically, in 2012-13, when mid-cap stocks were available really cheap, very few people wanted to buy them.
- In 2018, products that were overweight on NBFC or HFC sectors did very well.
- In ALL these cases, such No.1 products did not remain in that position.

The alternative is to stay invested in 4 or 5 investment products that are GOOD (and more importantly, different from each other) and not try to remain invested only in the product that is the BEST. The advantage of choosing a good investment product is that we can have several of them at the same time. The search for the best will leave us with only one product, and the best doesn't remain the best for long.

In our opinion, a good investment product is one that has a clearly articulated investment process, which is followed diligently even if it doesn't produce results all the time. The investor's interest is protected by choosing 4 or 5 products that are different from each other (essentially meaning 4 or 5 different approaches to achieve the same goal). Since topping the performance is a rotational phenomenon, the investor who does this is spreading his/her risk effectively. All good investment approaches will eventually converge to roughly the same level of performance. We have covered this topic in our earlier newsletters, and therefore are not repeating it here.

### What should an equity investor do at this stage?

We have never been comfortable about predicting the movement of the market index, but on the question about what an equity investor should do now, we have just this to say:

- It is not advisable to stay out of equity completely. We don't say this because we are equity investors. We are convinced that over a cycle, equity does prove to be a very good option, provided we choose the companies with care, and don't overpay for them.
- Within equity (whatever proportion that one is comfortable with), it is advisable to have a mix of different types of products, that follow different approaches towards equity investing. This ensures that the risk is spread out adequately. The effect of doing this may mean that these products would have different trajectories of returns (one may do better at one point, and the one that lags this year may do better in another year), but that is the whole idea of diversification.
- Split whatever investment that is proposed to be made in equity into equal installments, done over several months.

It is our fervent wish that the investment community, including the asset managers, wealth advisors, distributors and the investor, collectively realize the importance of not making the best an enemy of the good.

We wish all our investors, wealth advisors and distributors, and their family a safe stay during these difficult times, and look forward to meeting you in person soon after the lockdown is lifted.

Warm regards

Yours sincerely,

**(E A Sundaram)**
*Chief Investment Officer and Portfolio Manager*

"We must accept finite disappointment, but we must never lose infinite hope."

Martin Luther King

o3

| Top 10 Holding of o3 Core Value Strategy - Regular Scheme Option as on 30th April 2020 | | |
|---|---|---|
| **Name** | **GICS Sector** | **Weight** |
| Indraprastha Gas | Utilities | 6.30% |
| Colgate-Palmolive (India) | Consumer Staples | 6.22% |
| ITC | Consumer Staples | 6.02% |
| HDFC Bank | Financials | 5.47% |
| Oracle Financial Services Software | Information Tech | 5.31% |
| Castrol India | Materials | 4.80% |
| Container Corporation of India | Industrials | 4.48% |
| Sanofi India | Health Care | 4.33% |
| State Bank of India | Financials | 3.96% |
| Sundaram Finance | Financials | 3.69% |
| | | **50.58%** |

**Overweight / Underweight of Regular Portfolio Compared to Nifty 500 as on 30th April 2020**

| Sector | Underweight | Overweight |
|---|---|---|
| Industrials | | 18.82% |
| Consumer Discretionary | | 3.59% |
| Health Care | | 3.57% |
| Materials | | 2.01% |
| Consumer Staples | (0.29%) | |
| Real Estate | (0.55%) | |
| Communication Services | (3.12%) | |
| Utilities | (3.16%) | |
| Information Technology | (6.19%) | |
| Energy | (10.86%) | |
| Financials | (11.83%) | |

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

| Model Portfolio Details as on 30th April 2020 | |
|---|---|
| Weighted Average ROCE | 30.27% |
| Portfolio PE (1 year forward PE, Based on FY22) | 18.02 |
| Portfolio Dividend Yield | 1.77% |
| Average Age of companies | 62 Years |

| Model Portfolio Composition as on 30th April 2020 | |
|---|---|
| Large Cap | 42.5% |
| Midcap | 37.5% |
| Small Cap | 12.0% |
| Cash | 8.0% |

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 30th April 2020
- 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 30th April 2020
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 30th April 2020

| Model Portfolio Composition as on 30th April 2020 | |
|---|---|
| Model Portfolio Over Lap with Nifty 500 | 13.94% |
| Model Portfolio Over Lap with Nifty 50 | 14.39% |

| Consolidated Portfolio Performance of Core Value Concentrated Strategy | | |
|---|---|---|
| Period | 30th April 2020 | |
| | Portfolio | Nifty 500 |
| 1 Months | 11.41 | 14.52 |
| 3 Months | (15.11) | (18.75) |
| 6 Months | (18.77) | (17.30) |
| 1 Year | (13.33) | (17.09) |
| Since Inception (15/04/2019) | (13.70) | (17.37) |

| Consolidated Portfolio Performance of Core Value Regular Strategy | | |
|---|---|---|
| Period | 30th April 2020 | |
| | Portfolio | Nifty 500 |
| 1 Months | 12.51 | 14.52 |
| 3 Months | (16.61) | (18.75) |
| 6 Months | (17.76) | (17.30) |
| Since Inception (14/05/2019) | (11.37) | (12.52) |

- 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.

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