

# Traditional Market Conditioning: Why We Need to Break Away from It and How

By Team Multi-Act



*It is important to remember that all investments are subject to a certain amount of risk. 'Risk' can simply be defined as the probability of losing whole or part of the sum invested. This probability must be considered before investing. Various tools may be employed to identify investment-worthy stocks such as fundamental analysis, price-to-earnings ratio, technical and quantitative analysis. Fund managers may combine two or more systems to determine the strength of investment.*

*By and large, traditional investment strategies are based on a fixed percentage mix of stocks, bonds, and cash for varying risk tolerances. It is often the money manager's job to select the best investment options based on various theories that can be based on the long-term average performance of investment assets. For example, a moderate risk investor is likely to keep fully invested in 60 percent stock and 40 percent bond allocation without taking into consideration the risk. Institutions and fund managers may follow a relative investment approach, which in our opinion, has fundamental flaws as it focuses on short-term horizons*

*and fails to incorporate emerging trends.*

No matter what strategy is employed, the average investor tends to react to market volatilities. We believe that traditional market conditioning (that of reacting impulsively to changes in the market) is one that is not only highly risky, but also rash. While occasionally, it may result in massive short-term returns, in the long term, a planned, patient, and well-informed investment strategy is the better approach to investing.

Although 'risk' cannot be calculated as an exact number, the probability of doing well whilst investing is quite high provided a few rules are followed. However, many investors are guided by cues from newspapers, television or word of mouth making it difficult for them to stick to the rules of investment. In short, optimism forms market peaks and pessimism forms market bottoms. For example, a good rule is to buy when others are pessimistic but this can be extremely difficult due to negative news received from the various sources.

### Multi-Act Breaks the Mould of Traditional Investing

At Multi-Act, we apply forensic methods in order to ensure a rational, risk- controlled approach to investing. Companies are first assessed to understand if they are Moat or Non-Moats in order to apply the valuation process that is best suited for them. We use a four pronged approach, developed in-house, to assess Moat companies i.e. companies with long term competitive advantage and demonstrate solid financial performance and rising returns. This approach involves combining fundamental, technical, quantitative and behavioural analyses effectively to form our proprietary investment style – Global Rational Analysis Framework (GRAF).

The GRAF system enables our portfolio managers to look past short term fluctuations in the market allowing them to avoid falling prey to emotional decision making by choosing to be process driven. For example, avoiding investing in a company based on the sole fact that it is a brand moat. Our GRAF system allows us to answer the three main questions every potential investor should ask before making an investment, namely:

Is it a good company?  
Is the valuation right?

Is the timing right?

We also perform a systematic analysis to assess the quality and the sustainability of businesses in order to come up with a valuation range by using different valuation tools as may be applicable to a specific Company depending on the Company classification of “Moat” or Non-Moat”. We believe that “Moat” Companies should be valued using the Income Statement and “Non Moat Companies” should be valued using the Balance Sheet”. The qualitative assessment of our companies and business models relies on identifying the true sources of competitor advantages. This assessment is further backed up by quantitative criteria to avoid behavioural issues while also assessing competitive advantages allowing us to put together portfolios that are tilted towards high quality equities with low credit risk while giving a safety margin.

Here’s an example of our behavioural analysis of ITC from June 2015:



**What the market seems to be focusing on:**



**What we are focusing on:**



Excise duty increases and other regulatory actions/sanctions on cigarettes have lead to stagnant volumes for industry in last few years.



CMP at mid-band (fair-value) offers sufficient margin of safety and attractive prospective return for a long horizon investor.



Recent news flows were about by health advisory on cigarette packs and Maharashtra government banning sale of loose cigarettes



Above factors have played an overhang on the stock in the last one year. But this industry generates high revenues for the state and central governments, so unlikely that anybody would want to significantly hurt the industry over the long term.



Agri business segment has been observing adverse sales growth in last couple of quarters.



Cigarette segment OPM has seen improvement in last few years, despite adverse volume growth reflecting resilience of its pricing power.

Get Superior Risk-Adjusted Returns, Low Drawdowns

Take a look at this table that shows the benchmark performance (average BSE 500 and BSE

Midcap) against the performance of Multi-Act:



## Performance of MSSP-Our Flagship Product

### Each Financial Year & Since inception - As per SEBI Format

| Product  | Since Inception<br>(Annualized) | Current<br>year                | Financial<br>year ended | Financial<br>year ended | Financial<br>year ended | Financial<br>year ended | Financial<br>year ended | Financial<br>year ended |
|--|---------------------------------|--------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|  | 27.01.2011 to<br>30.04.2016     | 01.04.2016<br>to<br>30.04.2016 | 2016                    | 2015                    | 2014                    | 2013                    | 2012                    | 2011                    |
| Moat and Special Situations Portfolio (MSSP)*<br>Portfolio Performance (%), Net of all fees and<br>charges levied by the Portfolio Manager | 16.2%                           | 0.6%                           | 3.3%                    | 47.5%                   | 22.0%                   | 0.5%                    | 14.8%                   | 2.3%                    |
| Average Equity Weight  | 65.9%                           | 68.5%                          | 71.3%                   | 66.0%                   | 76.0%                   | 76.0%                   | 47.0%                   | 14.0%                   |
| Benchmark Performance (%) (Average of BSE<br>500 And BSE Midcap  | 7.6%                            | 3.1%                           | -3.8%                   | 41.4%                   | 16.2%                   | 0.8%                    | -8.4%                   | -2.2%                   |

#### Notes:














- \*Date of inception of MSSP is January 27, 2011.
- Past performance of MAECL does not indicate its future performance.
- Returns are cash flow adjusted and time (Daily) weighted returns after expenses & before Performance fees.
- The actual returns of clients may differ from client to client due to different timing of investment.
- Average Equity Weight is calculated as Monthly average of equity weight at end of the month.

How Are We Different?



<http://multi-act.com>

## How Are We Different?

|                         | <br><b>Multi - Act</b>  | <br><b>Industry in General</b>  |
|-------------------------|--|--|
|                         | <br>We invest our own money into the equities we recommend. We have our skin in the game. From the outset, Multi-Act was built by investors for investors.  | <br>There is no personal stake in the investment recommendations.   |
|                         | <br>PMS Services: We work on a no-brokerage fee system and therefore are able to offer unbiased advice, transparency, & trust.  | <br>PMS Services: Brokerage businesses work on commissions and therefore recommendations can be biased.   |
|                         | <br>Advisory Services:<br>•Research on 150 companies at cost of 1-2 analysts'<br>'Access to 20 investment professionals at the cost of 1 or 2'<br>•Total global coverage of 500 stocks. Cover 150 stocks in India on regular basis tracked over a decade or longer. Provide independent and conflict free research and investment advice. |  |
| <b>Macro</b>            | <br>Austrian School credit cycle framework  | <br>•Neo Classical Economics - ignores credit/debt and treats money as "neutral"  |
| <b>Micro</b>            | <br>•Quality of Earnings is very important<br>•Distinguishing moat and no moat business<br>•Risk vs Reward  | <br>•Quality of Earnings is given very little importance<br>•Does not distinguish between 'moat' and 'no moat' business for valuation purposes<br>•Focus on upside      |
| <b>Behavioural Edge</b> | <br>•Meets management only to understand business<br>•Focus on history and past trends<br>•Sustainability of returns – Adherence to process   | <br>•Focus on gathering information from management and other sources<br>•Focus on projections<br>•Skill of star fund manager/analyst to assimilate and use information |



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Our repository of data on 150 Indian companies and 350 global companies after 20 years of accumulating data allows us to have every investment supported by an Investment Thesis.

At Multi-Act, we understand that capital preservation is as important as growth. Our teams comprise principally of Chartered Accountants (the equivalent of CPAs in USA), statisticians and Economists who personify the foundations of providing sustenance, long-term goals and prosperity that Multi-Act is built on. Whatever your investing needs, from whether it is diversifying your portfolio to valuation of businesses, Multi-Act can help! Do [get in touch with us](#) to find out more.