Built by investors for investors

PMS NEWSLETTER - DEC 2019

Moats & Special Situations Portfolio

Contents

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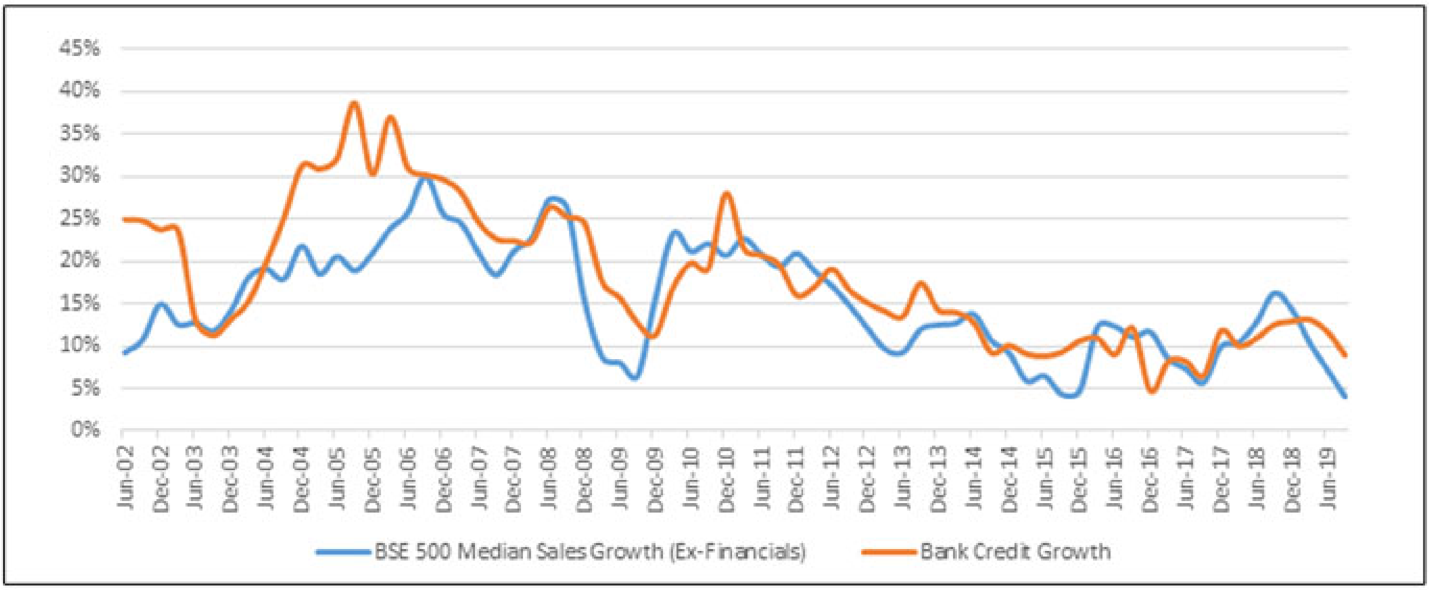
Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (M&SSP) as of 31st Dec 2019.

Portfolio Performance	Equity Allocation as on 31.12.2019	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		14.5%	10.1%
Dec 2019 Quarter	79%	3.6%	6.1%
1 Apr 2019 – Dec 2019		2.4%	0.4%

- Benchmark is an average of the BSE 500 and BSE Mid Cap index. Benchmark Performance is calculated using Total Return Indices.
- Equity allocation mentioned above is for older accounts.
- The above returns are consolidated for all clients, time weighted and post management and performance expenses.
- The actual returns of clients may differ from client to client due to different portfolio and timing of investment.
- Past performance is no guarantee for future performance.
- Inception Date is 27th January 2011.

The momentum that we saw in the Equity markets at the end of September, post the announcement of the Corporate tax cut, has continued into December quarter. But that is not true of the broader economic momentum. The Private sector Infrastructure and Capex engine has continued to be in hibernation for the last few years. Government expenditure on the Infrastructure side has been the only supporting factor. The consumption engine which has so far been resilient, has been losing steam in recent quarters. And the consumption slowdown for the first time in the recent past is far more severe in the Rural areas as compared to Urban regions.



Source: ACE Equity and RBI

Severity of the slowdown can be seen through the above chart which shows the BSE Median Sales Growth (Ex-Financials) and Bank Credit growth. The BSE 500 sales growth is the slowest it has been in the recent past. As per our assessment, post our interaction with companies during the quarter, December is expected to be as bad, if not worse.

But amidst all this doom and gloom, the Large Cap indices have touched all-time highs and continue to make new highs almost every week. This has been a common point of discussion during our interactions with prospective, as well as current investors. Arvind Subramanian the ex-Chief Economic Advisor at a recent public event had also commented on him being puzzled by the stock market making new highs when the economy is slowing.

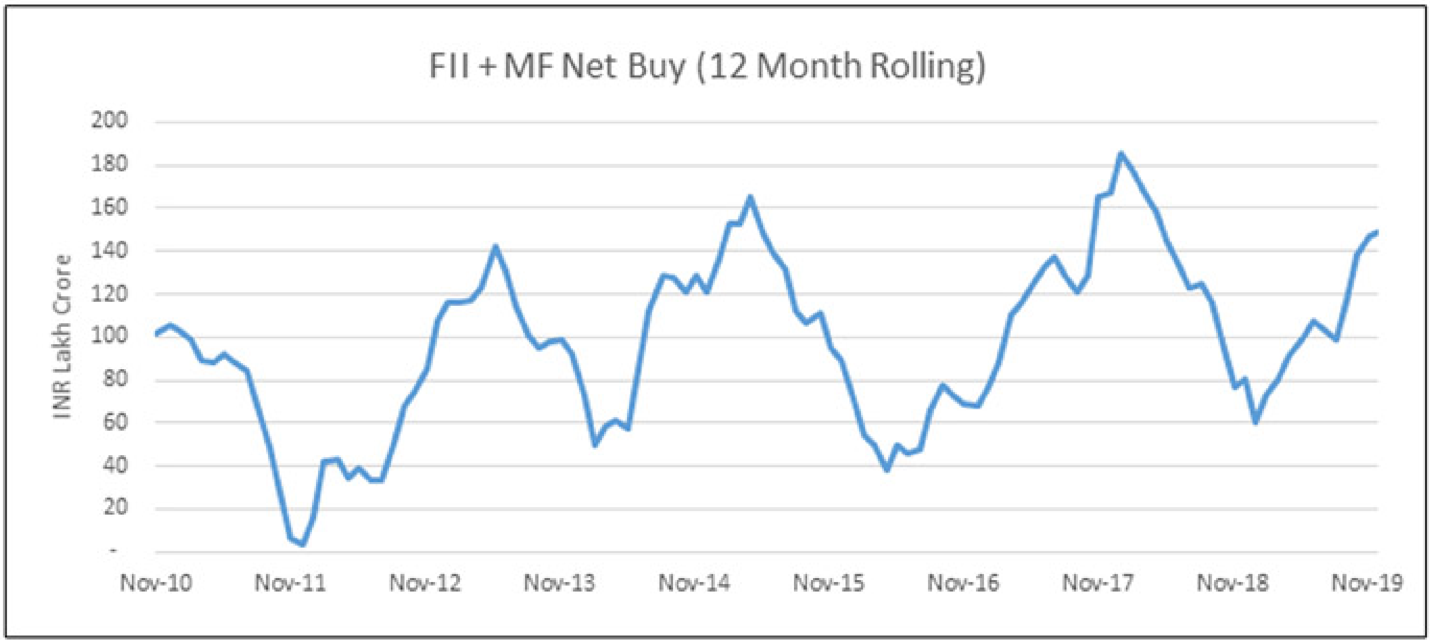
What is the reason for the disconnect?

Equity Markets are presumed to be "Forward Looking", by discounting current events and by factoring in future expectations. But that does not necessarily mean the market would be right in its prediction. And ultimately the market would readjust itself to new information that either confirms/contradicts its expectations.

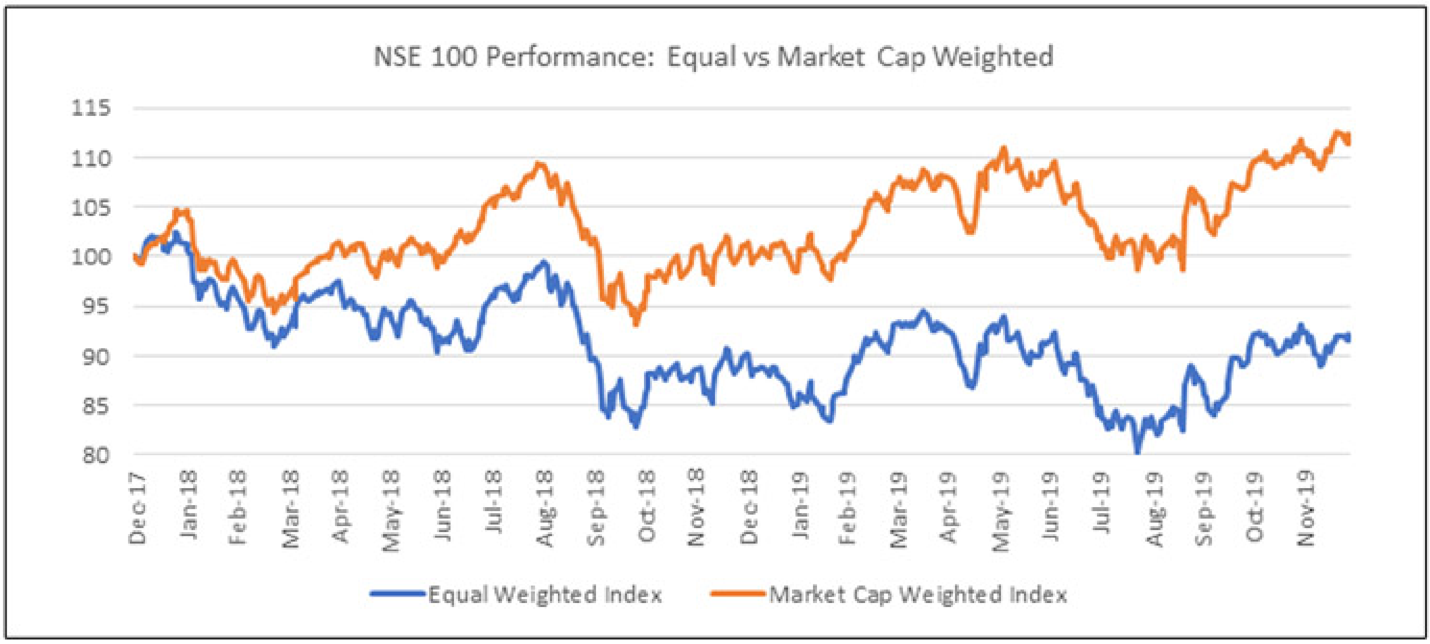
Is the Market "predicting" a recovery?

Looking at the headline indices, one could conclude that the indices are factoring a bounce in the economy. But headline index performance is deceptive. In fact, to some extent performance of frontline indices highlights fear of continuing weakness in the economy. While that may sound counter intuitive, we believe there are couple of factors – 1. Liquidity in terms of fund flows and 2. "crowding" of these flows in few select set of stocks, that are causing this phenomenon.

Firstly, Liquidity (from Equity flows perspective) has bounced back sharply with FII and MF flows almost back to earlier peak levels.



The question is where is this liquidity going? Take a look at the chart below. The chart shows the performance of NSE 100 Equal Weighted Index Performance vs NSE 100 Market Cap Weighted. The stocks in both Indices are the same, the only difference being weights. As the names suggest – all the stock constituents have equal weight in the NSE Equal Weighted Index. In case of Market Cap weighted index, weights are based on free float market capitalization. The chart suggests that stocks with higher Market Capitalization seem to have performed better than the market in general. The performance over various time frames is shown in the table below.



Source: NSE

NSE 100 Performance	Equal Weighted	M-Cap Weighted
6 Month	0.9%	3.2%
9 Month	-1.2%	4.1%
1 Year	2.1%	10.4%
2 year	-8.0%	11.7%
3 Year	23.1%	46.3%

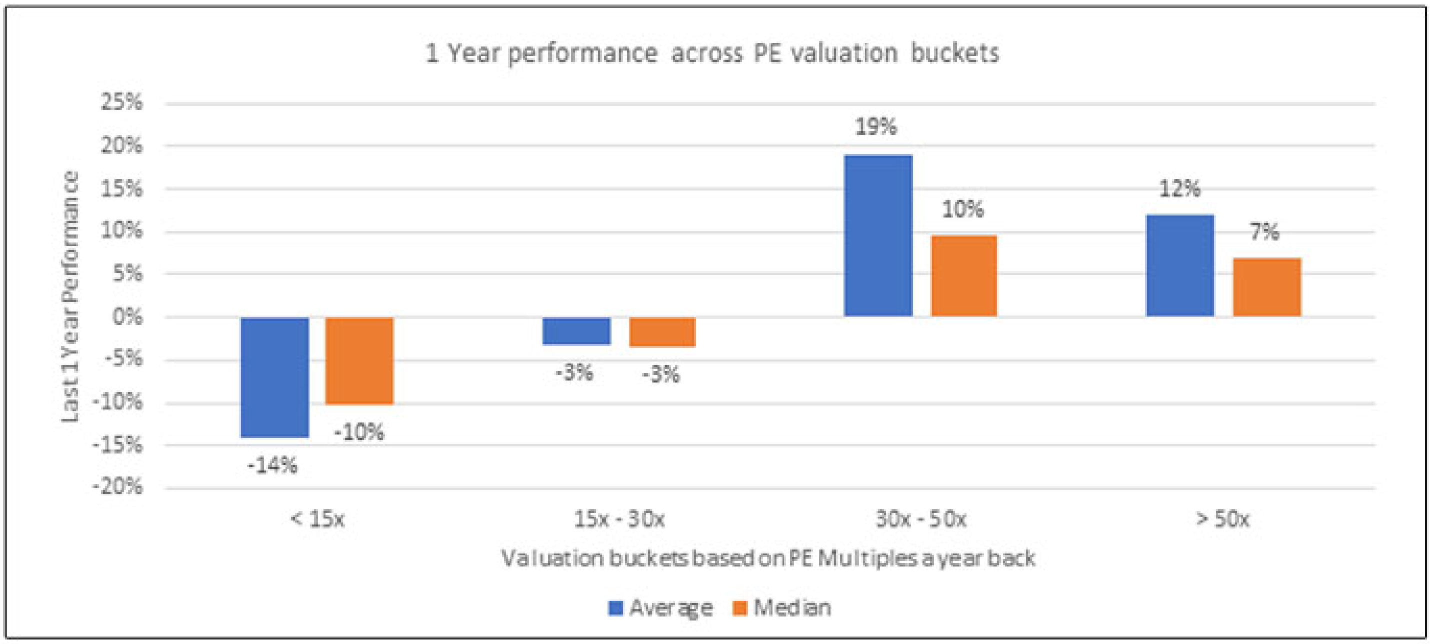
Source: NSE, (Numbers beyond 1 year are not annualized)

Across all recent periods the Equal Weighted Index has underperformed. But does an Equal Weighted Index "generally" underperform? On the contrary, Equal Weighted Indices generally do better than Market Cap weighted ones – Since the inception date of Jan 2003, NSE 100 Equal Weighted Index has delivered 16.6% return vs 15.9% of the MCap weighted index.

This divergence highlights "crowding" of fund flows in a few select stocks which have been pulling up the Mcap weighted index rather than the broader market. The uncertainty with respect to business performance of stocks in general is leading these funds to seek refuge in stocks that have visibility of earnings (actual or presumed), irrespective of valuation. Thus, leading to expensive stocks becoming even more expensive while stocks that have poor earnings visibility are being shunned.

We had discussed this point in our September quarter newsletter as well, using performance of stocks within various value baskets, which showcased the stocks in the Expensive and Super Expensive bucket outperforming the Value buckets. The same point can be showcased through simpler valuation buckets.

Below chart shows the performance of stocks within various PE valuation buckets for NSE 100 constituents. The stocks shows the last 1 year performance of stocks that were part of particular PE bucket as per the PE valuation a year back.



As can be seen from the chart, the best performing stocks are from the expensive bucket. In the above chart though, there is no filter of quality as compared to the one we had showcased in the September Quarter. We believe, the uncertainty with respect to earnings visibility has led to some of the quality businesses also correcting along with the broader market, which could provide a good opportunity for an investor who is willing to take a slightly longer-term view.

Tilting Portfolio Structure:

Last one year has been "relatively" poor for our portfolio. The below table summarises the relative underperformance.

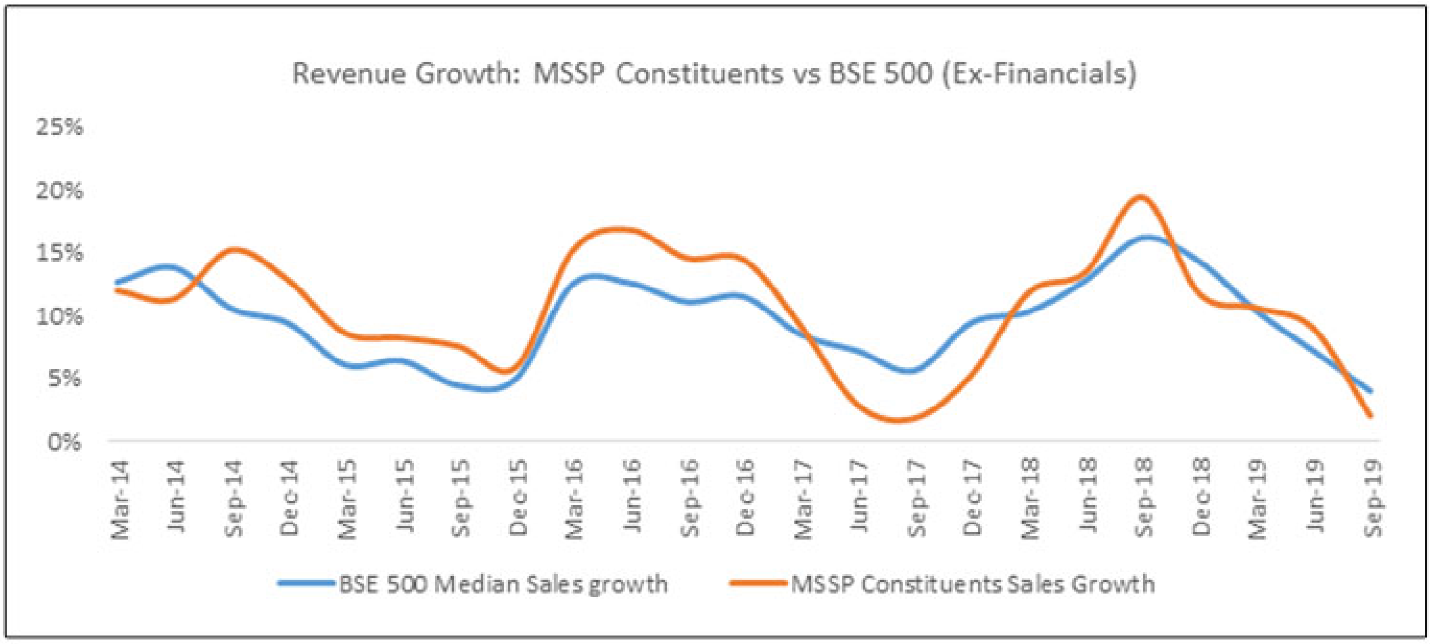
Performance	Last 1 Year
MSSP	3.8%
Benchmark	3.5%
NIFTY	13.5%

Benchmark: BSE 500 + BSE Midcap

The outperformance of NIFTY vs our portfolio is stark. The outperformance of the NIFTY could be partly explained by the strong performance of few select stocks, especially index heavy weights that we alluded to in the previous section. However, the NIFTY 50 Equal Weighted Index performance in the last 1 year is around 2.7%, which again showcases the discrepancy in performance by a few select heavy weight stocks. But part of the underperformance is also because we have been building a portfolio with a contrarian stance.

We have been witnessing weakness in High Quality cyclical stocks due to the current slowdown. These businesses are finding less sponsorship in the market due to poor near term earnings visibility. We believe however, these are durable businesses going through a cyclical slowdown rather than a structural one. Thus, our portfolio structure is again tilting in a contrarian manner wherein we are consciously adding names where Quality and Valuation parameters are being met, but companies may have near term negative earnings growth and poor visibility (e.g. Auto Sector).

Such a portfolio could underperform in the short run, until the cycle turns in our favour. Like our Portfolio positioning in 2017, we are trying to build a portfolio of stocks, many of which may have near term negative earnings momentum, but which in our opinion are mispriced because of that. The chart below reflects the Sales growth of our Portfolio constituents vs BSE 500 median Sales growth (Ex-Financials).



The contrarian stance proved to be early in 2017 and hurt our relative performance at that time, but when the business momentum for our portfolio companies turned, we were able to outperform in a meaningful manner which more than compensated for the underperformance of 2017. Such a contrarian strategy allows us to build a good quality portfolio with strong prospective return- which is always our consistent endeavor. The stocks that we have been adding to the portfolio in the last 6 months would give you a flavor of this strategy.

Asset Allocation:

Our overall equity weights stand at around just under 80% for older accounts. For new accounts our initial weight is around 40%, with several companies becoming potential investee's on a small correction.

Portfolio Activity:

Business Model and Sector Allocation:

Moat/Limited Moat	Mar-19	Jun-19	Sep-19	Dec-19
Moat	27%	23%	33%	30%
Limited Moat	45%	46%	38%	44%
Moat + Limited Moats	**72%**	**69%**	**71%**	**74%**
Special Situations	25%	27%	26%	22%
Regulated Utility	3%	4%	3%	4%
Grand Total	**100%**	**100%**	**100%**	**100%**

Sectors	Mar-19	Jun-19	Sep-19	Dec-19
Financials & Financial Services	14%	15%	18%	20%
Auto & Auto Ancillaries	8%	8%	16%	17%
Information Technology	19%	18%	12%	16%
Pharma	19%	17%	16%	15%
Materials	10%	12%	10%	10%
FMCG	12%	10%	10%	8%
Capital Goods	9%	9%	8%	8%
Utility	3%	4%	4%	4%
Media	3%	3%	3%	3%
Logistics & Transport	3%	4%	4%	-
Grand Total	**100%**	**100%**	**100%**	**100%**

Portfolio Activity during the quarter:

This quarter we have added Tata Elxsi. The company is in ER&D Outsourcing space catering to segments of auto, broadcasting and medical devices. There is a trend of increasing software led R&D as well as increased outsourcing for R&D in these end-user industries. Though Elxi's business has been impacted in the last one year due to a significant drop in revenues from its largest customer (JLR), we understand that JLR business has now bottomed out. In addition to this, the Healthcare & Medical devices segment which is currently only 8% of sales is expected to scale up significantly over the next few years due to strong deal pipeline that the company and the industry in general are witnessing in that segment. Thus, while the negativity with respect to JLR is being factored in the valuation, the upside from the growth in Medical segment is not fully priced in the valuation.

We exited Interglobe Aviation. Our original thesis was that of rationalization of capacity in the industry. Indigo being the most efficient player, would have weathered he near-term weakness, better than any other participant. In the last one year, we witnessed the collapse of Jet Airways which led to a significant drop in capacity. But the vacuum was immediately filled in by Spice Jet and Indigo in a very short period of time. The Industry is back above the Pre-Jet Crisis capacity level and still adding capacity. Considering the stock had run up substantially and was trading around the expensive zone as per our valuation estimates, all the positives with respect to Jet Airways exit were already factored, we decided to exit the stock.

Regards,

Rohan Samant	Rohan Advant
Sr. Portfolio Manager	Sr. Portfolio Manager

Statutory Details: Portfolio Manager – Multi-Act Equity Consultancy Private Limited (Registration No. INP000002965)

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Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Composite representing the Moats and Special Situations portfolio was created on 27th January 2011. Performance has been compared with Total Return of the Index. For Moats & Special Situations Composite, blended benchmark of BSE 500 (50% weight) and BSE Mid Cap Index (50% weight) has been used. The Gross Return is before all expenses (except Brokerage). Net Return is after all actual expenses. A complete list of composite descriptions, policies for valuing portfolios and calculating performance fees are available on request.

Multi-Act Equity Consultancy Pvt. Ltd. is an independent SEBI registered Portfolio Manager. The firm maintains a complete list and description of composites, which is available upon request. This MSSP Composite includes all discretionary fee paying portfolios that are being managed with the objective of generating capital appreciation by investing in companies that in the opinion of the Portfolio Manager are of high quality Moat or Limited Moat businesses at fair value or discount to fair value OR in Non Moat businesses at deep discount to fair value as special situations. The portfolio manager has also the discretion of not being fully invested if he is not able to find ideas that meet the above criteria along with valuation criteria, thus, indirectly taking an asset allocation call between Equity and Cash (& Cash Equivalents).

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Risk factors
General risk factors

a. Securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.

b. Past performance of the Portfolio Manager or its affiliates does not indicate its future performance.

c. Investors are not being offered any guaranteed or assured returns i.e. either of principal or appreciation on the Portfolio.

d. As with any investment in securities, value of the Client's Portfolio can go up or down depending on the factors and forces affecting the capital market.

e. The Portfolio Manager is neither responsible nor liable for any losses resulting from the operations of the Portfolios.

f. The investments made are subject to external risks such as war, natural calamities, and policy changes of local / international markets which affect stock markets.

g. The Portfolio Manager has renewed SEBI PMS registration effective October 14, 2014 and has commenced its portfolio management activities with effect from January 2011. However, the Portfolio Manager has more than 10 years of experience in managing its own funds invested in the domestic market.