



**"HEADS: WIN LESS
TAILS: LOSE A LOT"**

Multi-Act Equity Consultancy Pvt. Ltd.

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Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (M&SSP) as of 30 Sep 2021.

Portfolio Performance ¹	Equity Allocation	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		15.6%	13.5%
Sep 2021 Quarter	70%	6.5%	12.2%
Apr-Sep 2021		11.6%	24.4%

Economic activity is coming back on track as Covid cases and positivity rate dropped across most parts of the country. With 25% of the adult population in the country fully vaccinated and around 69% with one dose, we are moving in the right direction to address the current health crisis. Demand across most sectors is back to normal. Barring a 3rd wave, economic activity and business performance should do well in the coming quarters.

Global supply chain issues and commodity inflation have been a cause of concern. Commodity prices haven't cooled off yet and energy prices (Crude, Natural Gas, Coal) have also jumped sharply recently. Most global Central banks have continued with their stance that the current inflationary pressures seem to be transitory, driven by supply chain bottlenecks and should normalise over time. But as most companies pass on the cost inflation to their customers we will have to see if the current cost pressures seep into inflation expectations.

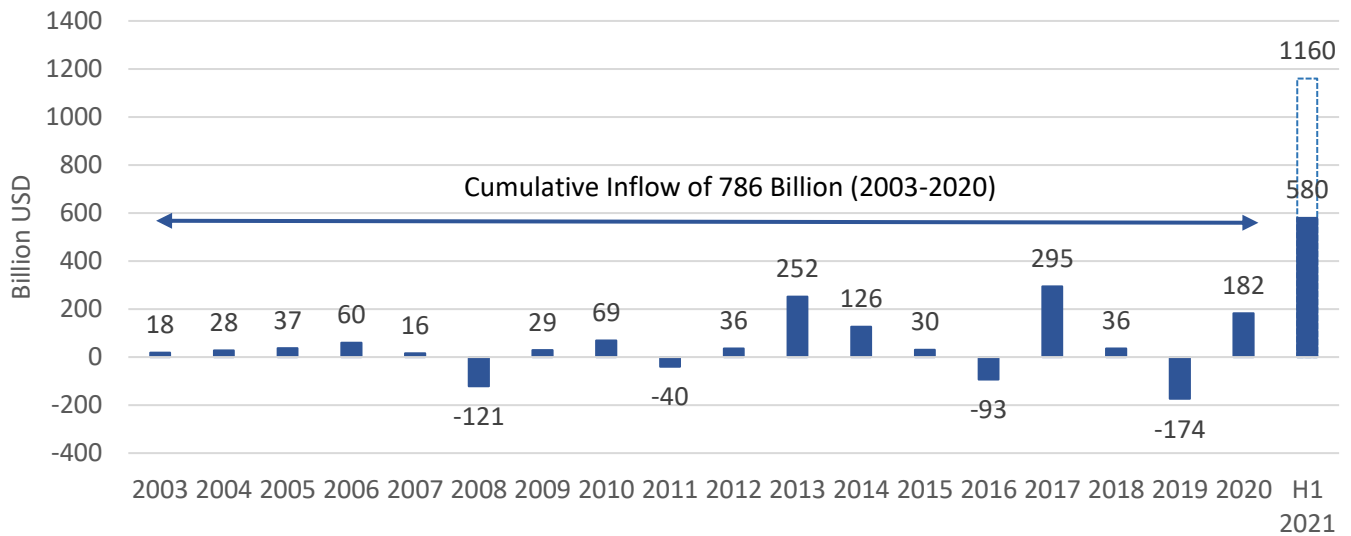
Commodity Price Increase	From Pre-Covid	Last one Year
Crude	22%	91%
Coal	248%	310%
Natural Gas	173%	130%
Steel	54%	62%
Copper	45%	36%
Aluminium	59%	64%

As Indices continue to make new highs, the Covid crisis seems to be a distant memory. The worst correction in the NIFTY in the last one year was -7.5% in April during the second wave. One may wonder, if the Indices could have reached such heights in the absence of a Covid crisis? We would attribute the exuberance to the side-effects of firefighting done by governments and central banks globally. Post Global Financial Crisis, the Central Banks have come to the rescue every time the markets have faced any sharp declines. The frequent firefighting is leading to an illusion of "no tail risk" in equities. As this perception becomes ingrained in investor psyche, the desire to take risk continues to go up.

This is reflected in the unprecedented global flows in equity funds of around 580 Billion USD (1160 Billion if annualised) in the first half of the current calendar year, as against a cumulative inflow of 786 billion since 2003-2020 (around 650 Billion in last 10 years).

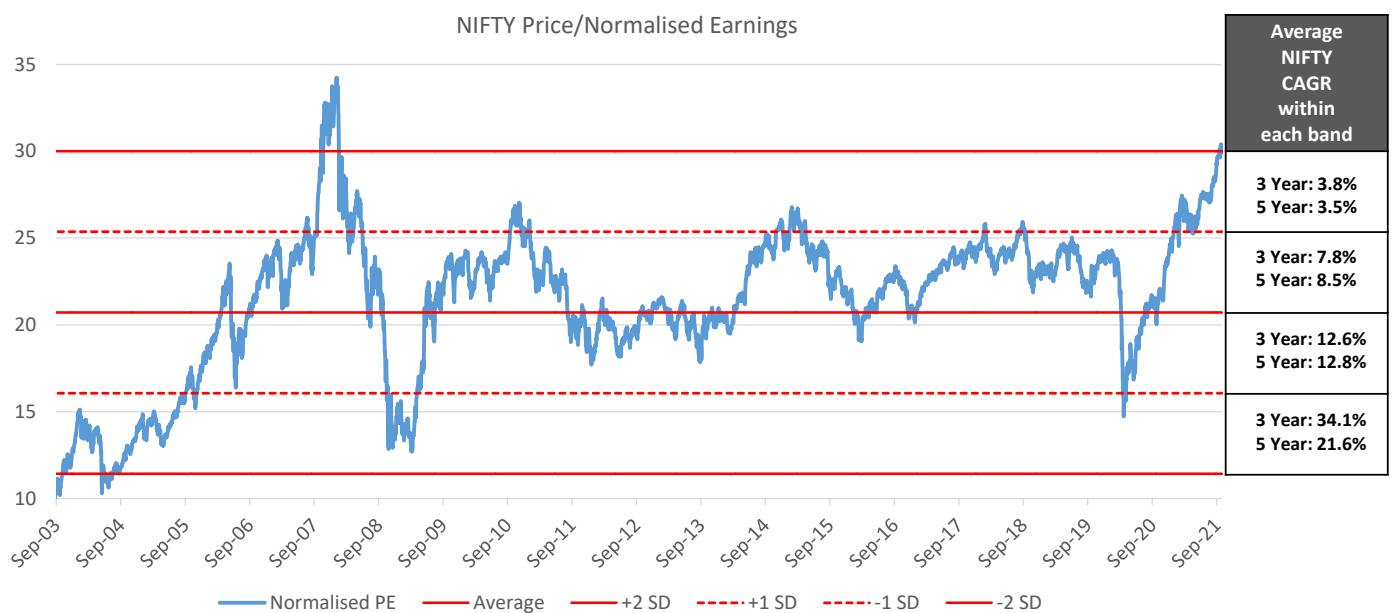
¹ Benchmark is an average of the BSE 500 and BSE Mid Cap index. Benchmark Performance is calculated using Total Return Indices. Equity allocation mentioned above is for older accounts. The above returns are consolidated for all clients, time weighted and post management and performance expenses. The 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.

Global Flows in Equity Funds

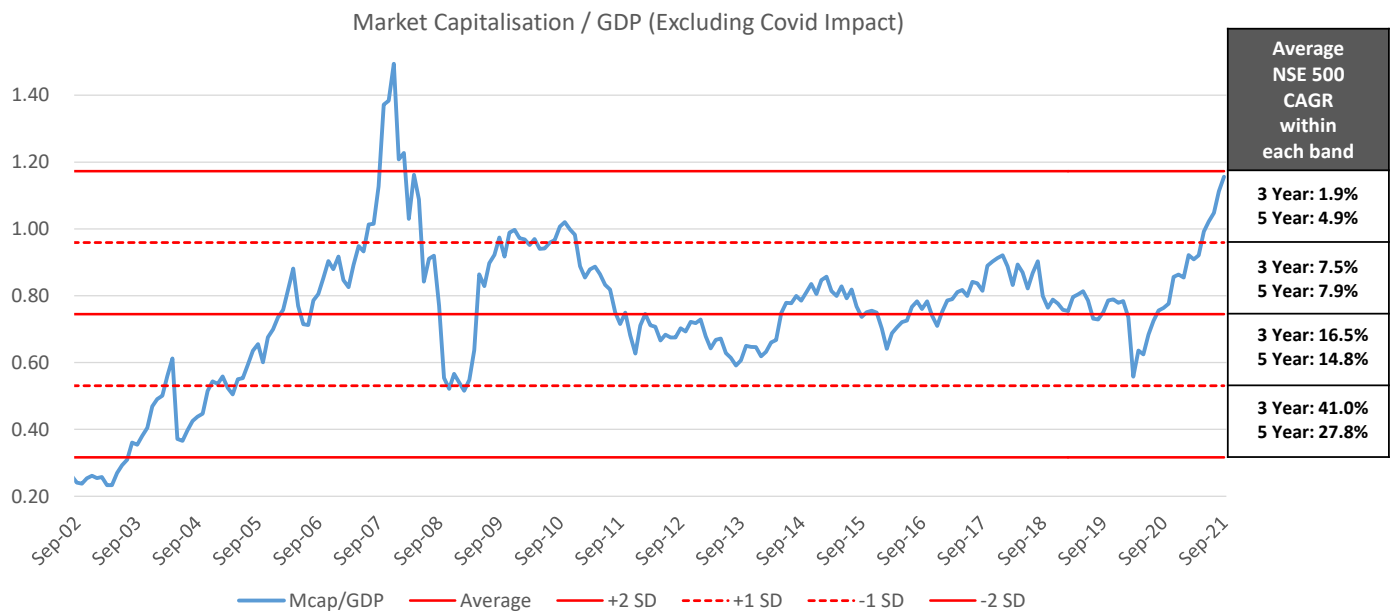


Source: BoFA Global Investment Strategy, EPFR Global, FT

As risk appetite continues to go up, we believe equities are being priced to deliver low prospective returns. The chart below shows the historical Normalised NIFTY PE ratio. The adjoining table shows the Average CAGR return generated over forward 3 year and 5-year period if you would have invested at any point within the Standard Deviation bands shown. As one would intuitively expect, there is a high negative correlation (-0.87) between starting normalised PE valuation and the prospective 3 year returns. i.e. Higher the starting PE, lower the prospective return and vice versa. Thus, if the historical correlation holds, NIFTY could be priced to deliver a return lower than the risk free rate (G-Sec 10 year yields).



Similarly, looking at the broader market (NSE 500) through the Market Cap/GDP ratio and comparing the returns of a broader NSE 500 index over the next 3 year and 5 year period gives a similar outcome. The Market Cap/GDP ratio has high negative correlation (-0.86) with 3 year prospective return of NSE 500.



While from a historical valuation point of view, equities could be priced to deliver lower prospective return as discussed above, is there a possibility that - *This time is different?*

Do high valuations reflect (predict) imminent high growth in the future?

During valuation extremes one common argument used to disregard valuations is that they merely reflect the future i.e. market prices reflect the expectations related to future earnings. Thus if valuations are high, they reflect an imminent high growth phase. But do expectations have any predictive value? If we compare the NIFTY valuations at the start of the period vs the future 3 years earnings CAGR, the correlation is -0.77. Thus, it conversely suggests **Higher valuations have been followed by Lower NIFTY EPS growth, whereas Lower valuations have been followed by Higher NIFTY EPS growth.** The negative correlation here could be completely incidental, due to the Low valuation period of 2002-2004 being followed by high earnings growth period. Suffice to say, there is no correlation.

Similarly, if we compare MCap/GDP valuation vs future 3-year GDP CAGR, there is -0.08 correlation (virtually no correlation).

Thus, these two data points suggest there is no predictive value of current valuations on future earnings/GDP growth. Since high expectations are built in the current valuations, we could be setting ourselves up for a negative surprise. The cost of a negative surprise (read drawdown) would be far higher than the gains that could be made if the expectations are met when valuations are as elevated as today.

But Low interest rates have structurally altered valuations?

One common justification given for current elevated valuations is the global low interest rate environment. Low interest rate regime has forced investors globally to take more risk in search of yield. This has led to mispricing of risk, as investors accept lower prospective returns on riskier assets (not only equities, but other asset classes as well) by bidding up the prices, in turn leading to returns being front loaded. Valuation rerating driven by continuation of a low interest rate regime could ultimately lead to two outcomes – a. If the current low interest rate environment sustains, investors will merely experience the lower prospective

returns being factored at current valuations OR b. If the interest rate regime starts normalising, valuations would also normalise leading to potentially large negative return. Thus, while it ensures low prospective returns in the best case, it doesn't leave room for negative macro events OR an unexpected eventual normalisation of monetary policy which could negate the current narrative.

Heads I win less, Tails I lose a lot

When we scan our investable universe today from a bottom-up perspective, we observe very limited opportunities. For a new client we can deploy only 25% on day one (since we don't follow a model portfolio). This is probably the lowest equity weight for a new client on day one since the inception of this strategy. Thus, whether we look at it from a top down or with bottom-up perspective, we are in "Heads I win less, Tails I lose a lot market" with the odds extremely unfavourable for an investor. Our cautious stance over the last 9 months has evidently hurt our relative performance. But as Indices move from expensive to super expensive valuations, we continue to be willing to sacrifice near term performance to make your portfolio resilient to an eventual normalisation of the current extremes.

Asset Allocation

Our overall equity weights stand at around 70% for older accounts. For new accounts our initial weight is ~25%.

Portfolio Activity

Business Model Allocation	Dec-20	Mar-21	Jun-21	Sep-21
Moat	21%	19%	22%	25%
Limited Moat	43%	49%	44%	42%
Moat + Limited Moats	64%	68%	66%	67%
Special Situations	32%	28%	30%	28%
Regulated Utility	4%	4%	4%	5%
Grand Total	100%	100%	100%	100%

Sector Allocation	Dec-20	Mar-21	Jun-21	Sep-21
Financials	32%	28%	29%	29%
FMCG	16%	21%	22%	20%
Financial Services	10%	9%	9%	10%
Information Technology	9%	7%	10%	8%
Real Estate & Infrastructure	-	3%	7%	7%
Auto & Auto Ancillaries	6%	6%	7%	6%
Capital Goods	2%	2%	2%	6%
Utility	8%	7%	5%	5%
Pharma	7%	7%	5%	5%
Materials	10%	10%	4%	4%
Grand Total	100%	100%	100%	100%

Portfolio Activity During the Quarter

We added a Defence PSU to the portfolio. The revenue of this company is closely linked to Defence Capital expenditure. The budgeted defence capital expenditure has increased by 18% for FY22. This visibility is also corroborated by the order pipeline of the company. The company is trying to increase revenue mix of its non-defence business (currently ~20% of revenue). Governments focus on indigenisation and increasing non-defence revenue provides good medium term revenue visibility. This new addition provides good diversification to the portfolio as the business is relatively delinked to economic activity. We were able to add this to the portfolio at reasonable valuation due to adverse reaction to June quarter results, which is not relevant as majority revenue of the business is booked in Q3 & Q4 of the financial year.

We exited L&T Technology Services (LTTS). The ER&D services companies, including LTTS, are seeing very strong business tailwinds and deal pipeline. While LTTS had turned expensive 6 months back, we continued to hold on to our weight given the strong visibility. But recently valuations had already started factoring FY25 optimistic scenarios, which left very limited upside in our opinion. Thus we decided to exit the stock.

Regards,
Rohan Samant

Rohan Advant

Chief Investment Officer

Sr. Portfolio Manager & Associate Director

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

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Note:

1. All cash holdings and investments in liquid funds, is considered for calculating the performance.
2. All performance data are reported net of all fees and all expenses (including taxes).
3. The above performance numbers are not verified by the SEBI

Disclosure as per Global Investment Performance Standards (GIPS®) –

Multi-Act Equity Consultancy Pvt. Ltd. claims compliance with the Global Investment Performance Standards (GIPS®). You can refer to the GIPS Compliant performance presentation here. Multi-Act Equity Consultancy Pvt. Ltd. has been independently verified by M/s. M. P. Chitale & Co., Chartered Accountants for the periods April 1, 2011 through March 31, 2019. The verification is available upon request. MAECL has claimed GIPS compliance for the Financial Year 2021 and such performance numbers shall be made available upon request.

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).

The information provided in this document should not be construed as a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in the composite or that the securities sold will not be repurchased. The securities discussed do not represent the composite's entire portfolio. Actual holdings will vary depending on the size of the account, cash flows, and restrictions. It should not be assumed that any of the securities transactions or holdings discussed will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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 December 04, 2020 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.

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