

# “WHEN YOU SEE NO RISK”



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 31 Mar 2021.

Portfolio Performance	Equity Allocation as on 31-03-21	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		15.2%	11.8%
Mar 2021 Quarter	72%	5.1%	10.1%
1 Apr 2020 – 31 Mar 2021		62.3%	85.8%

- 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 financial year 2021 has been eventful. The health crisis and its impact on economic activity has not been witnessed for many generations (probably since the Spanish Flu of 1918-1919!). In the Equity market, sentiment moved from peak pessimism in March 2020 to optimistic within a very short period as Central Banks injected massive liquidity. But just as we were incorporating a scenario where the worst of the crisis could be behind us, a second wave of the pandemic has started in many parts of the country. True, the government may not opt for a stringent lockdown as seen in the first wave being mindful of the economic impact of the earlier lockdown on businesses and the livelihoods of low-income households. However, we could have localised lockdowns, and the economic recovery could be affected to some extent with such localised lockdowns. All things considered, in terms of sentiment and economic impact, the second wave might not have a similar magnitude of impact as the first.

December quarter results have been good, especially from profitability perspective. Most businesses are back to pre-covid levels. Global commodity prices though, have increased materially in the last few months. As can be seen from the adjoining table we have seen a sharp jump in commodity prices in the last 6 months. Most commodities are materially higher than pre-covid (Dec-19) prices as well. Raw material cost inflation across industries therefore would affect margins. Some companies have started passing on the higher cost to their customers, which could reflect in the inflation numbers in coming months.

Commodity Price Increase	From Pre-Covid levels	Last 6 Months
Crude	-2%	53%
Coal	33%	51%
Steel	26%	32%
Iron Ore	82%	35%
Copper	44%	35%
Aluminium	25%	32%
Lithium	72%	118%

The government announced an increase in budgeted Capital expenditure on Infrastructure. The crisis has given an opportunity to deviate from the fiscal deficit target without a very negative reaction amongst bond investors. There will be an increased fiscal deficit (6.8% in FY22) and longer timeline (FY26) to bring down the overall fiscal deficit to 4.5%. This compares with the previous target of 3.5% fiscal deficit target for FY21 before we entered Covid crisis.

Global commodity rally and increased fiscal deficit (not just in India but globally) could lead to inflationary pressures. We could have seen the bottom in domestic interest rates, save far higher Central Bank support to the Fixed Income markets.

The equity markets reacted positively to the changed government stance on the fiscal deficit and increased Capex spend. Investors are comfortable with the narrative that the long-awaited capex up-cycle might be around the corner. We have seen sector rotation during the quarter in the equity market. Cyclical materially outperformed the traditional defensives and Low quality outperformed High Quality. High Quality has of course materially outperformed Low quality since 2011; and such temporary periods of underperformance are clearly reasonable. Sentiment shift amongst equity investors is clearly visible, with a cyclical recovery being taken for granted.

Indices	March Quarter Performance
<b>Defensives vs Cyclical:</b>	
BSE Metals	23.7%
BSE Industrials	21.3%
BSE Infrastructure	19.5%
BSE Capital Goods	12.5%
BSE IT	9.5%
BSE Consumer Durables	8.0%
BSE Auto	6.9%
BSE Bankex	4.6%
BSE FMCG	2.1%
BSE Healthcare	-1.6%
<b>High Quality vs Low Quality</b>	
<i>Multi-Act Low Quality Index</i>	21.0%
<i>Multi-Act High Quality Index</i>	3.9%

### When you see “No Risk”

Our March 2020 Newsletter was titled – “When all you see is Risk”. In March 2020, investors were doing stress tests on every business and worrying about the structural impact of Covid. Valuations were being benchmarked with the Global Financial Crisis/or the 2003 period on already pessimistic estimates. Within a year those risks seem like distant memory. Today, investors are calculating valuations factoring a cyclical recovery and perhaps incorporating peak valuation multiples. This change in sentiment makes the market far riskier today- in terms of the possibility of suffering a “permanent loss of capital”- as compared to March 2020. A paradox of investing, it is far less risky when everyone is focused on risk, as equity valuations factor those risks. Conversely, risk is high when it is invisible or ignored.

In the December quarter newsletter, we had discussed valuations being elevated from a historical perspective – whether you look at NIFTY, Midcaps or Small caps. From such elevated valuations the experience for equity investors has been low returns generated over the next 3-5 years. We had recently written a [blog](#) about how the odds are stacked against an investor when valuations are expensive by comparing historical valuation and subsequent 3 and 5 year returns.

Using the same data on Normalised NIFTY PE Valuation, we have tried to understand what would have been the experience of an investor at any point in history when the NIFTY Normalised PE was similar to its Current valuation or higher (i.e. >26x normalized PE)?

The average return (CAGR) generated over the next 3 or 5 years has been a paltry 2.4%.

The table Below converts the historical experience into a probability distribution.

**Historical experience of Investing at valuations like today:**

CAGR Return	Probability over next	
	3 Year	5 year
More Than 10%	-	-
8% - 10%	1%	-
6% - 8%	11%	9%
4% - 6%	17%	17%
2% - 4%	24%	33%
0% - 2%	27%	18%
Negative Returns	21%	22%
<b>Total</b>	<b>100%</b>	<b>100%</b>

To re-iterate an equity investor who would have invested at any point in history when valuations were as elevated as they are today, would have had a zero probability of generating a return more than 10% (CAGR) over the next 3 years/5 years. As per this historical experience, the probability of generating returns above the risk-free rate are a low 12% (3 years) and 9% (5 years) and there is 20%+ probability that you would have ended up with a negative return after 3-5 years. What this table does not show is the intermediate drawdowns (sharp corrections) that you would have had to go through over this 3–5-year investment period. The drawdowns in any holding period would have been between a negative 23% to as much as negative 60 %

The Normalised PE at the time of investment and the subsequent 3 year/5-year return has very high (negative) 88% Correlation. The higher the valuation, the lower the prospective return. If history repeats itself, the prospective returns from a 3–5 year perspective could be disappointing.

An environment where investors are willing to lower their guards & ignore elevated valuations as per the historical record is usually associated with the concomitant fear of missing out on opportunities (FOMO). After all, valuations could always become even more elevated! Such an environment lends itself to investors getting caught in the narrative and ignore the data. So, staying disciplined is all the more difficult, but remaining disciplined and staying true to a process we believe is the only thing that helps when the tide unexpectedly and inevitably turns.

### Asset Allocation:

Our overall equity weights stand at around 72% for older accounts.  
For new accounts, our initial weight at this time is ~33%.

### Portfolio Activity:

#### Business Model and Sector Allocation:

Moat/Limited Moat	Jun-20	Sep-20	Dec-20	Mar-21
Moat	31%	22%	21%	19%
Limited Moat	42%	46%	43%	49%
<b>Moat + Limited Moats</b>	<b>73%</b>	<b>68%</b>	<b>64%</b>	<b>68%</b>
Special Situations	23%	28%	32%	28%
Regulated Utility	4%	4%	4%	4%
<b>Grand Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Sectors	Jun-20	Sep-20	Dec-20	Mar-21
Financials	26%	28%	32%	28%
FMCG	14%	15%	16%	21%
Materials	8%	9%	10%	10%
Financial Services	8%	12%	10%	9%
Information Technology	8%	11%	9%	7%
Utility	8%	7%	8%	7%
Pharma	11%	8%	7%	7%
Auto & Auto Ancillaries	13%	6%	6%	6%
Capital Goods & Infrastructure	5%	5%	2%	5%
<b>Grand Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

### Portfolio Activity during the quarter:

We added Wabco India to the portfolio. Wabco has a dominant position in active safety systems (Braking, Stability control etc) for commercial vehicles. Globally Wabco has a much wider portfolio of products which could be launched in the domestic market. This would help the company to grow faster than the domestic commercial vehicle industry as there is scope to increase content per vehicle. Wabco India has low cost of operations and is used as a manufacturing hub for certain products within the global supply chain of the group. ZF Group had acquired Wabco group (Parent of Wabco India). Post the global acquisition, ZF group had to make a mandatory open offer to Wabco India shareholders last year as per SEBI Takeover regulations. Promoter Shareholding in the company had thus, gone up to 93%. But as per SEBI's Minimum public shareholding regulations, the promoters must bring down their stake to 75%. To meet these regulatory requirements, the promoters recently came out with an Offer for Sale (OFS). Due to the OFS, there was forced technical selling in the stock, and we were able to add it to the portfolio at a reasonable valuation.

We exited Hero Motocorp. Visibility for domestic two-wheeler segment has again turned a bit hazy with an increasing pileup of inventory. Increasing commodity prices are also expected to impact margins. We believe the elevated valuations were not factoring the risk of subdued demand and margin pressures and exited.

Regards,  
Rohan Samant  
Sr. Portfolio Manager &  
Associate Director

Rohan Advant  
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 2020 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).

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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 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.