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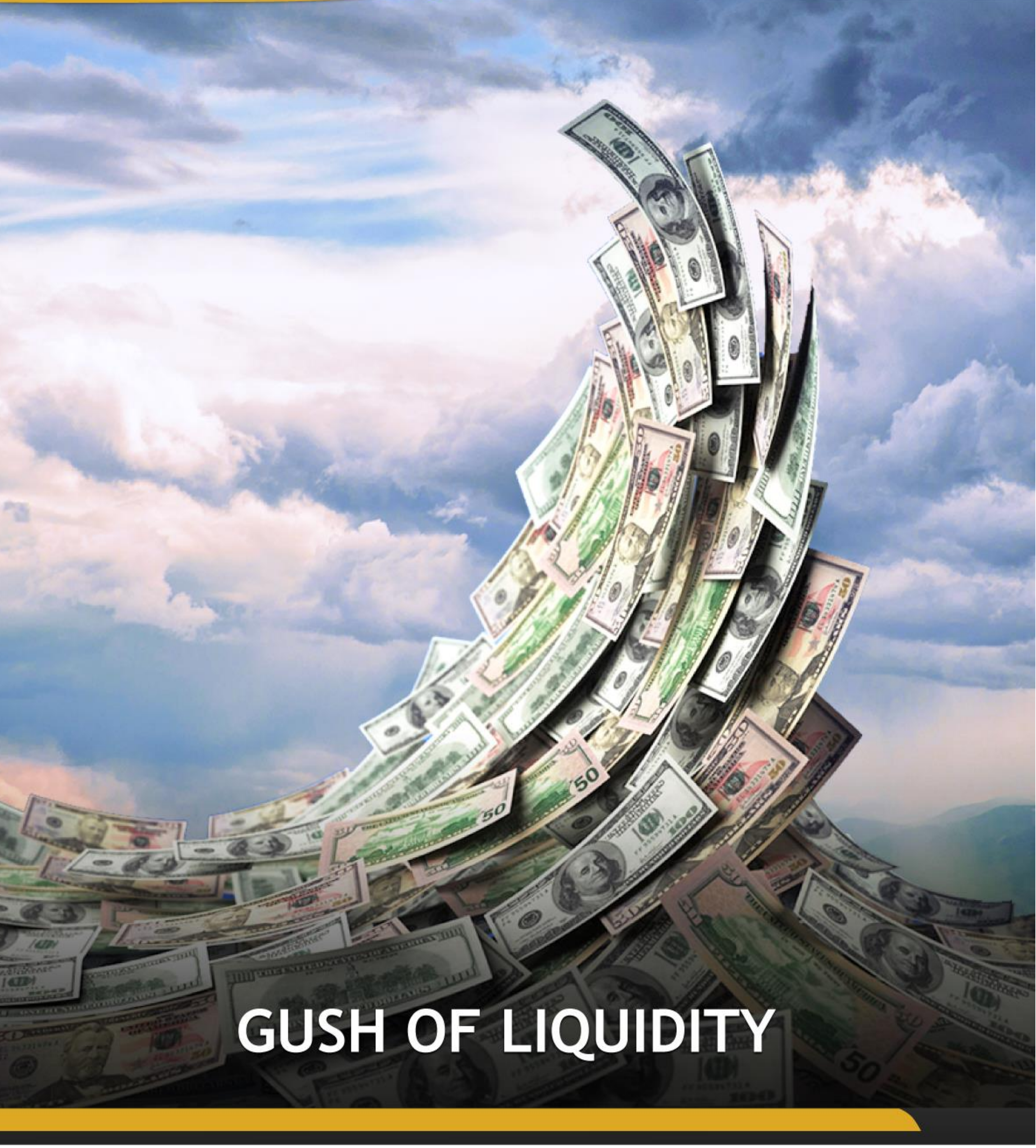
PMS NEWSLETTER | DEC - 2020
Moats & Special Situations Portfolio



GUSH OF LIQUIDITY

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Date: 31st Dec 2020

Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (M&SSP) as of 31 Dec 2020.

Portfolio Performance	Equity Allocation as on 31-12-20	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		15.0%	11.1%
Dec 2020 Quarter	68%	17.4%	22.9%
1 Apr 2020 – 31 Dec 2020		54.4%	68.6%

- 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.

In the December quarter we witnessed a strong rally across global equity markets aided by positive news on Covid-19 vaccines, a large and continued (USD 900 Billion) fiscal stimulus announcement in the US and no surprises in US Presidential Elections. Multiple Covid-19 vaccines completed trials successfully much ahead of earlier expectations and initial rounds of vaccinations have already started. With effective vaccines in place, the worst of the pandemic could be behind us. By and large the Global economy continues to recover well from the Covid-19 induced impact. Economic activity in India is normalising as well. September quarter results were weaker compared to the corresponding quarter of last year. But numbers were broadly better than market expectations, especially with respect to profitability. Financial markets have already forgotten the Covid-19 scare as we end the calendar year materially (+15% vs last CY) above pre-Covid levels.

Gush of Liquidity

Emerging markets have seen massive inflows from Foreign Institutional investors since November. The November month alone witnessed around USD 40 Billion fund flow into Emerging Market Equities and December month is expected to be similar. These are record flows as compared to history. FIIs invested around 65 Thousand Crores (USD 8.8 Billion) in November and around 48 Thousand Crores (USD 6.5 Billion) in December in Indian Equity market. The massive flows have driven the rally in the last two months and have inflated valuations.

Trailing NIFTY Price to Earnings (PE) ratio is currently at 38x which is highest from a historical perspective. But this is not the right ratio to look at in the current environment. The reported PE ratio is affected by exceptional drop in earnings that we saw in the first 2 quarters of FY21 due to Covid related disruption. We had argued in our March Quarter newsletter, that such a temporary drop in earnings does not affect intrinsic value of businesses and thus we should look at earnings excluding this extraordinary disruption. Even if we adjust for the drop in earnings due to Covid, the PE would be ~31x - still expensive at around +2 SD of historical average.

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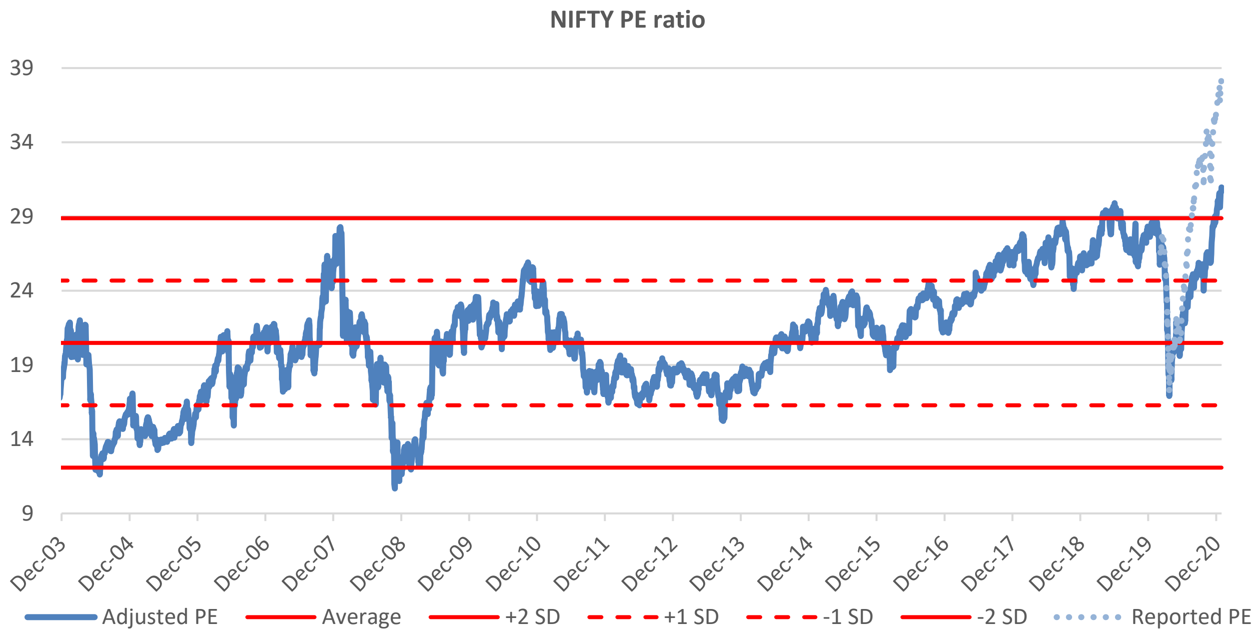
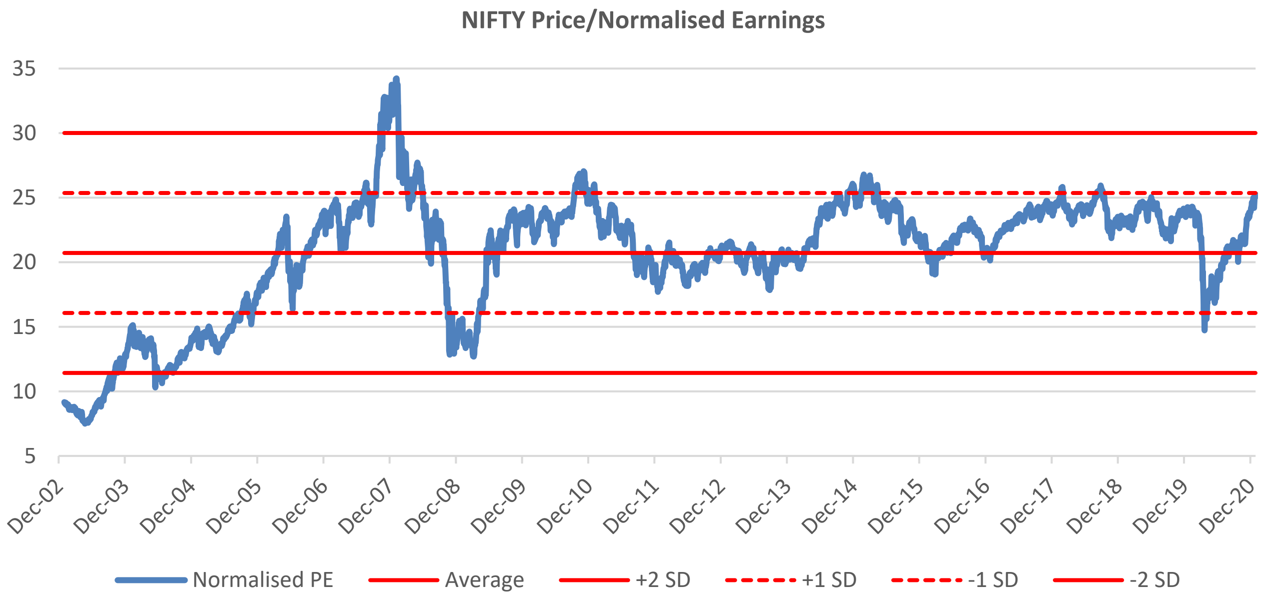


But we have been going through a phase of slow earnings growth in the last few years. Thus, it is important to look at PE assuming normalised earnings based on trend earnings growth rate for NIFTY. Below chart represents NIFTY PE normalised for trend earning growth. Even on a normalised earnings basis, the NIFTY is in the expensive zone (+1 Standard Deviation) as compared to history.



Thus, no matter how one looks at it, valuations for NIFTY are expensive in context of historical multiples.

If we look beyond the NIFTY (which represents the Large Capitalisation companies) and refer to valuation of Mid and Small cap indices, we also find similar levels of overvaluation. Based on reported earnings, Median PE ratio of index constituents (refer to light blue dotted line) is already above +2 SD and close to 2017-18 peak multiples. But if we adjust the PE ratio by excluding earnings impact of Covid then Median PE ratio is above +1 Standard deviation, but still below 2017-18 peak multiples.

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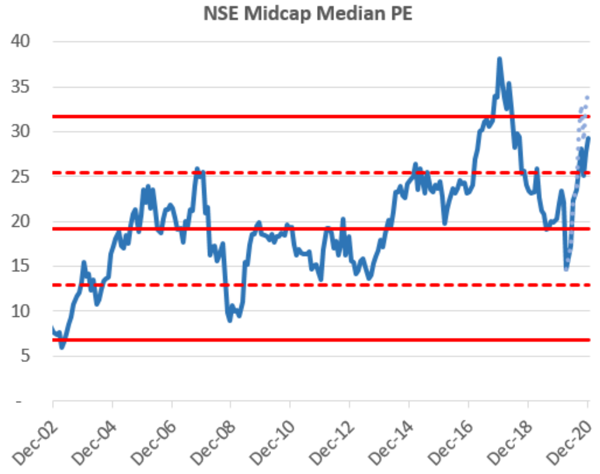

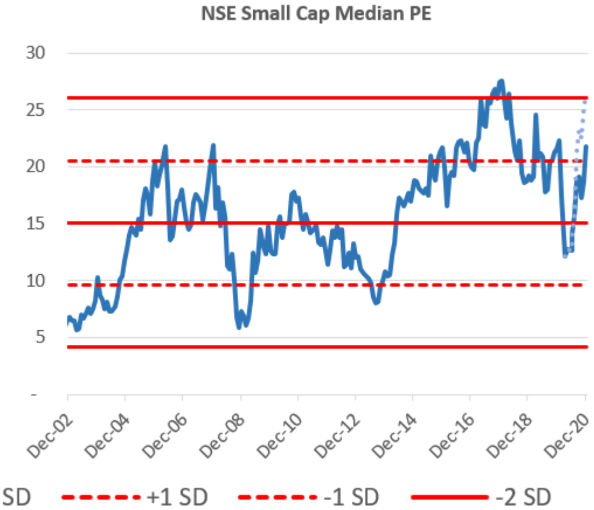

Low interest rates prevailing globally, have forced investors seeking better returns, to take relatively more risk by investing in equities. But can prolonged period of low interest rates structurally alter valuations?

If interest rates are expected to remain benign for the foreseeable future and thus investors have repriced equities with lower discount rates, **the corollary is lower prospective returns from equities.** Alternatively, if the low interest rates are able to achieve the objective of re-igniting growth and normalising inflation, then interest rates and valuations would normalize as well, leading to a derating cycle. The only possible positive outcome, is continued expansion of Central Bank balance sheet with interest rates moving further lower and for some countries deeper into negative territory, thus continuing the valuation rerating cycle due to yield chasing. Still there are limits to such a process, though market participants seem happy, at this stage to ignore the limits.

High market valuation does not mean a market crash is imminent. But it does reflect low prospective return with increasing risk of material drawdown. With valuations turning more expensive, reward vs risk in equity indices is increasingly looking adverse.

Asset Allocation:

Our overall equity weights stand at around 68% for older accounts. For new accounts our initial weight is less than 30%. Investable opportunity set for us continues to shrink. In the current rally we have exited stocks which were expensive (discussed in later section) and increased weights in some of our existing names where reward vs risk remains favourable. Though our overall equity weight has still reduced as compared to the September quarter. Even after the recent rally, we believe there is value in the Financial sector and unusual for us, we find our highest weights to that sector.

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Portfolio Activity:

Business Model and Sector Allocation:

Moat/Limited Moat	Mar-20	Jun-20	Sep-20	Dec-20
Moat	33%	31%	22%	21%
Limited Moat	39%	42%	46%	43%
Moat + Limited Moats	***72%***	***73%***	***68%***	***64%***
Special Situations	24%	23%	28%	32%
Regulated Utility	4%	4%	4%	4%
Grand Total	**100%**	**100%**	**100%**	**100%**

Sectors	Mar-20	Jun-20	Sep-20	Dec-20
Financials	22%	26%	28%	32%
FMCG	14%	14%	15%	16%
Financial Services	9%	8%	12%	10%
Materials	8%	8%	9%	10%
Information Technology	11%	8%	11%	9%
Utility	7%	8%	7%	8%
Pharma	10%	11%	8%	7%
Utility	7%	8%	7%	7%
Auto & Auto Ancillaries	12%	13%	6%	6%
Capital Goods	6%	5%	5%	2%
Media	2%	-	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**

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Portfolio Activity during the quarter:

We exited GE Power from the portfolio. This action was necessitated by change in the business rather than valuation. Our core thesis behind investing in GE Power was related to the Pollution control equipment opportunity. Government had mandated all thermal power plants to install pollution control equipment by 2022. GE Power was one of the main contenders in this opportunity with the parent having one of the largest installed base of this equipment globally. But recently GE global, the parent company, announced its intention to exit the Coal Power business and along with it the pollution control equipment business as well. And while GE Power India clarified that they would continue to participate in the tendering for this opportunity in the domestic market, the opportunity size would shrink as they may not be able to participate in the government business, purely on its own capability. This change put our core thesis at risk, and we decided to exit.

CDSL has been one of the biggest beneficiaries of increased participation of retail investors and new account openings by discount brokers recently. The business of CDSL can be split between annuity revenue and market linked revenue. The annuity revenue is a steady revenue base that grows at a relatively low rate. The market linked revenue is driven by volumes being traded in the market, IPOs, account openings etc which go through cycles. The scale up of the market linked revenue has been the trigger for rerating in the stock. The market linked revenue by our estimates, could be at (or closer to) peak coupled with peak valuation multiples. We decided to exit the stock from a valuation perspective.

We exited Tata Elxsi. The company witnessed good recovery in business from the crisis along with improving visibility. But we believe valuation has run ahead of fundamentals and thus exited the stock.

We exited SBI Cards and Kotak Bank similarly on valuation grounds and poor estimated prospective returns. We increased our weights in some of the existing financial sector stocks in the portfolio which we believe are attractively priced.

We did not add any new name during the quarter, but increased weights in some of our existing positions.

We would like to end this letter by wishing you a Happy and Prosperous New Year and 2021.

Regards,

Rohan Samant
Sr. Portfolio Manager &
Associate Director

Rohan Advant
Sr. Portfolio Manager &
Associate Director

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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 is yet to complete the GIPS audit. The GIPS number shall be made available once the verification is completed

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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