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Sankhya India Portfolio

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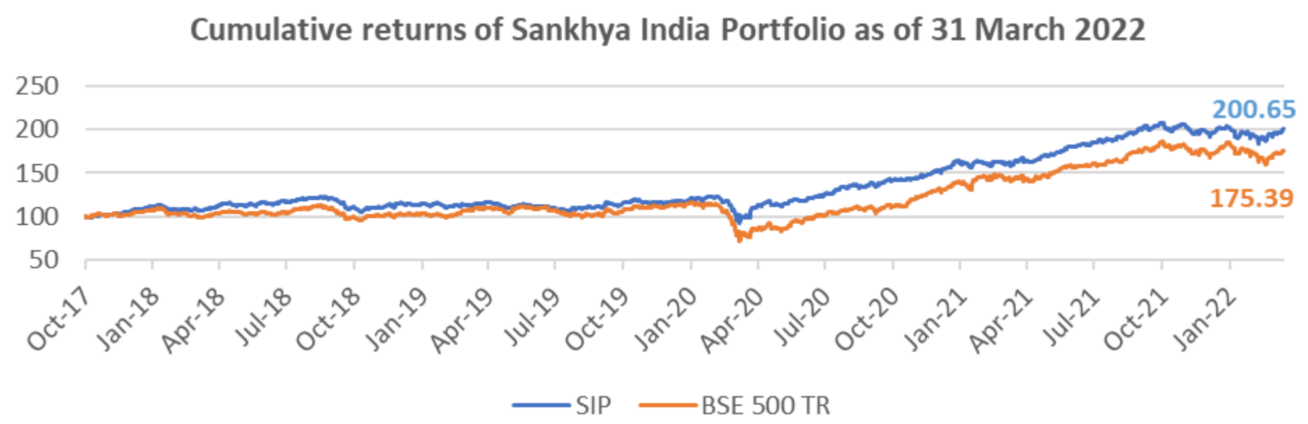
Dear Investors,

We are pleased to share with you our first Sankhya India Portfolio (SIP) newsletter and our performance since inception and over the last few highlighted periods.

Portfolio Performance	Total Portfolio Returns	BSE 500 TR Returns
Since Inception 17 October 2017 (annualised)	16.93%	13.49%
Annual: 1 April 2021 to 31 Mar 2022	22.85%	22.26%
Quarter: 1 Jan to 31 Mar 2022	-0.19%	-0.25%
Month: 1 Mar to 31 Mar 2022	4.88%	4.24%

Performance of SIP vs BSE 500 TR index since inception date 17 October 2017



In the initial period, SIP performed in line with the index. However, both during the Covid crash and subsequent recovery, SIP performed in accordance with its objective of a lower drawdown and quicker recovery, reflecting the high underlying returns of its portfolio constituents. It has continued to maintain a lead over the index since. Since October 2021, SIP's performance has been comparable to its Benchmark.

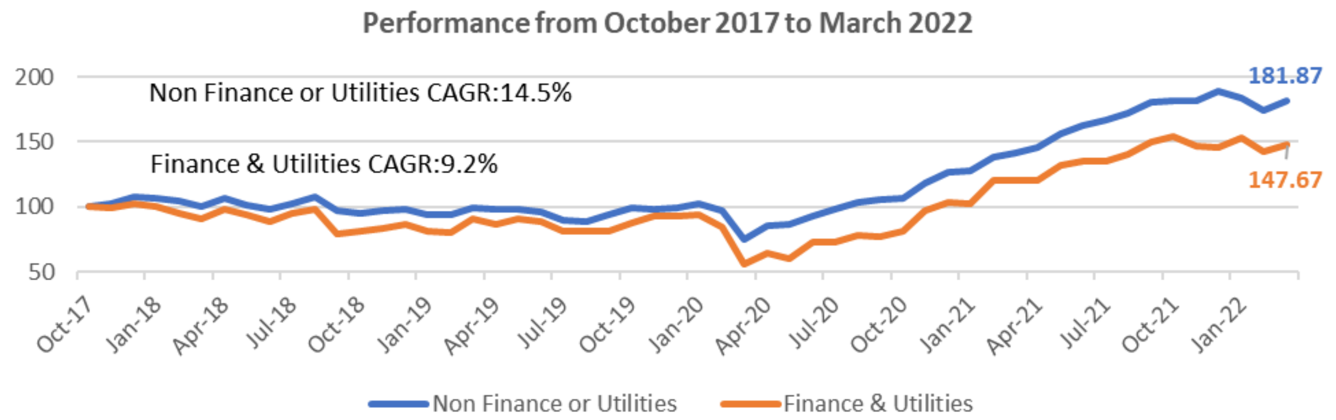
Sankhya India Portfolio limits its investment to Large- and Mid-cap (the top 250 companies as per market cap). There are four building blocks to portfolio construction for SIP portfolios, viz. *removing finance and utilities*, *removing low (poor) quality companies*, and selecting the best combination of *profitability* and *value*.

Let's review the performance of each of these factors independent of the other.

1. **Impact of removing finance and utilities from the universe of 250 stocks**

Quantitative strategies generally exclude Financials and Utilities. These sectors typically have higher leverage, higher dividend yield and lower PE Ratios. They can therefore distort any strategy that includes "value" as a factor by *over selecting such companies*. Chasing Earnings Growth in financial companies is a inferior strategy as sometimes poor underwriting may lead to growth. Utilities generally have fixed output & stable earnings and earnings growth is typically not an attribute associated with this sector. Therefore, dividend yields, or PE ratios appear optically low and security selection in Quant portfolios can be tilted in the favour of such stocks to the detriment of the final performance of a Quantitative Portfolio.

How has the removal of these two sectors impacted the performance of the resulting universe?

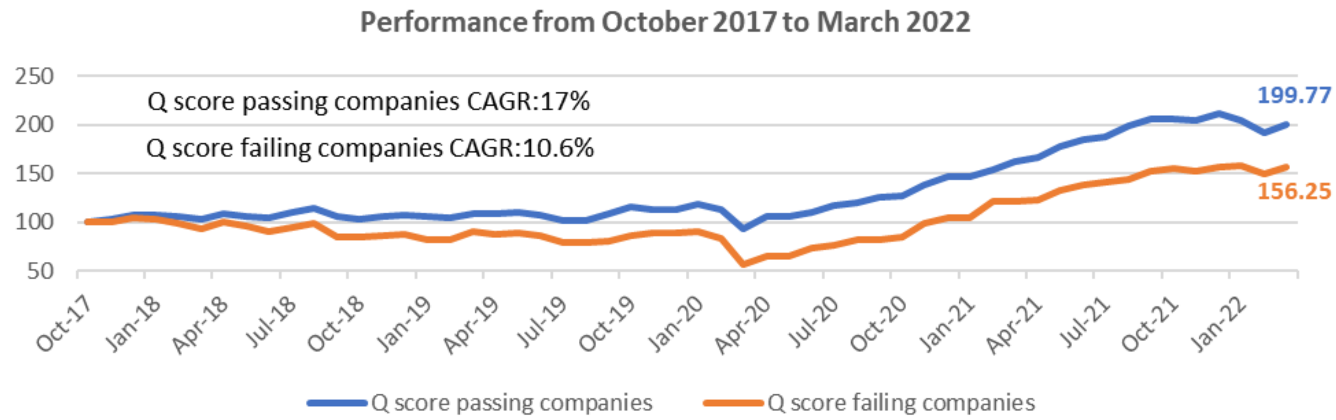


As seen above the performance of financials + utilities stocks basket is consistently less than that of the remaining ones. Hence this step of removing financials and utilities has helped the strategy in stock selection.

2. **Impact of Quality criteria**

While investing in companies, we want to avoid investing in low-quality companies. We define quality of a company by a proprietary 5-parameter score called Q-Score, which tests whether a company is generating returns above the cost of capital with positive operating cash flow while possessing a favourable debt to equity structure. We have found that this Q-Score sufficiently differentiates low-quality stocks from the rest.

Companies that score less than 5 are said to be low (poor) quality companies and are removed from the universe. Following chart shows the performance of companies passing and failing the Q-Score criterion.

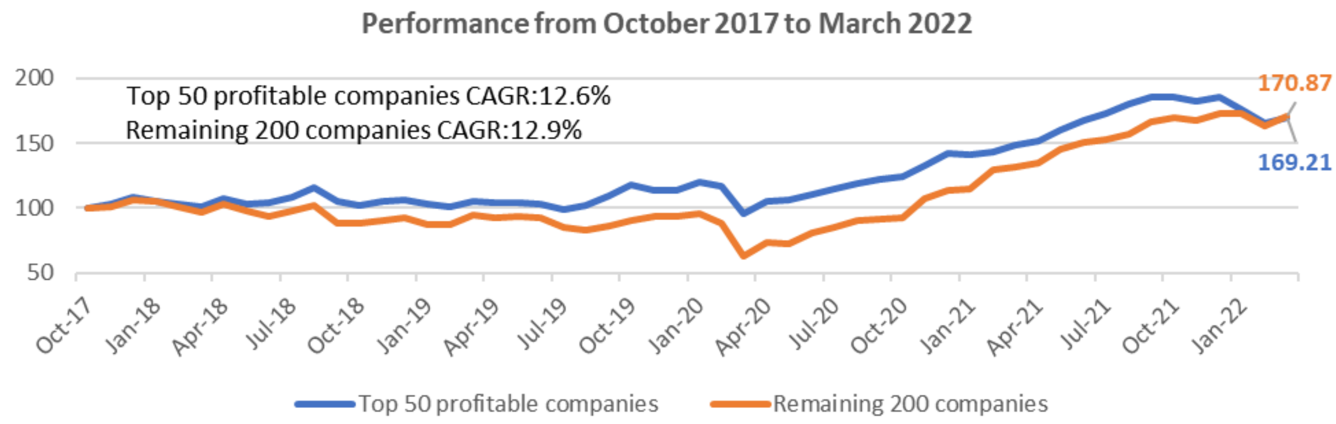


The performance of companies passing our proprietary Q-Score, is consistently better than those failing Q-Score. Since January 2022, low-quality companies however have started gaining (or falling less) than high-quality companies, usually an anomalous feature in a “rational” market .

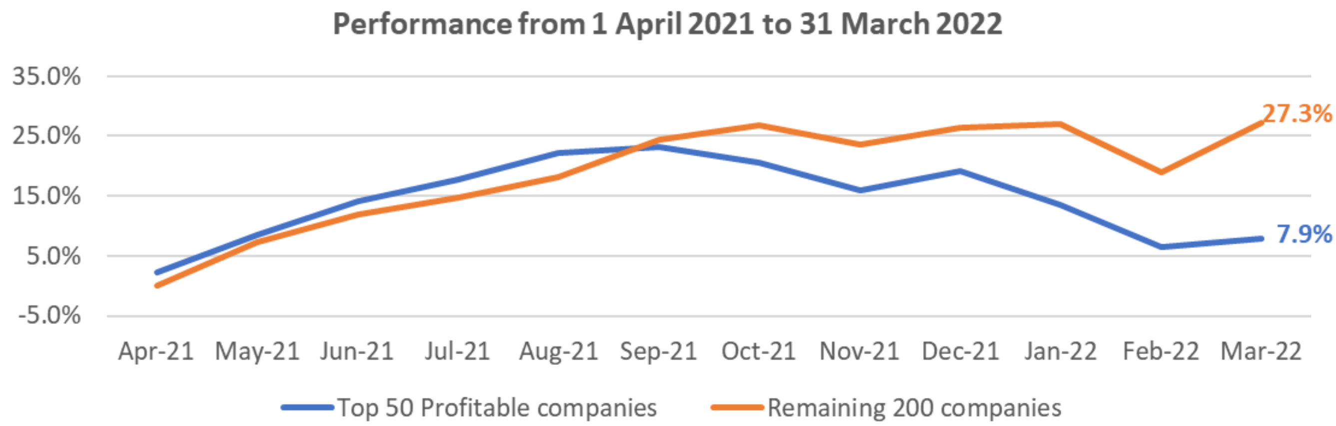
Next, Sankhya chooses the best combination of profitability and value to finalize the list of 30 stocks. To review whether each of these factors work, we will study the performance of top 20% i.e., 50 stocks with highest profitability with remaining stocks, and top 50 stocks with highest value with remaining stocks.

3. Performance of profitability factor

In our historical analysis as well as actual fund management, we have found that the profitability factor is consistently rewarded by the market. But there are a handful of years when the most profitable companies underperform the rest. The following chart shows the performance of the 50 most profitable companies as compared with rest of the universe.



The profitability factor has worked as expected for most of the period since SIP inception. In the recent period though, the performance of the less profitable companies in the universe has accelerated to catch up with the 50 most profitable companies. How has this year been for the 50 most profitable companies?

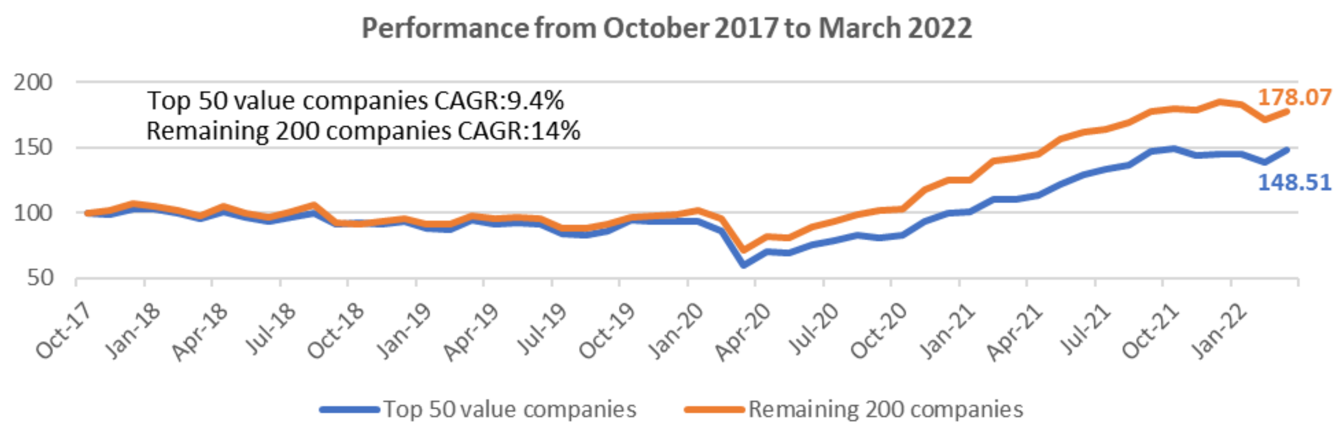


Till September 2021, the basket of the 50 most profitable companies performed well. But post 1st October 2021, the returns of the remaining companies have substantially outperformed that of the 50 most profitable companies.

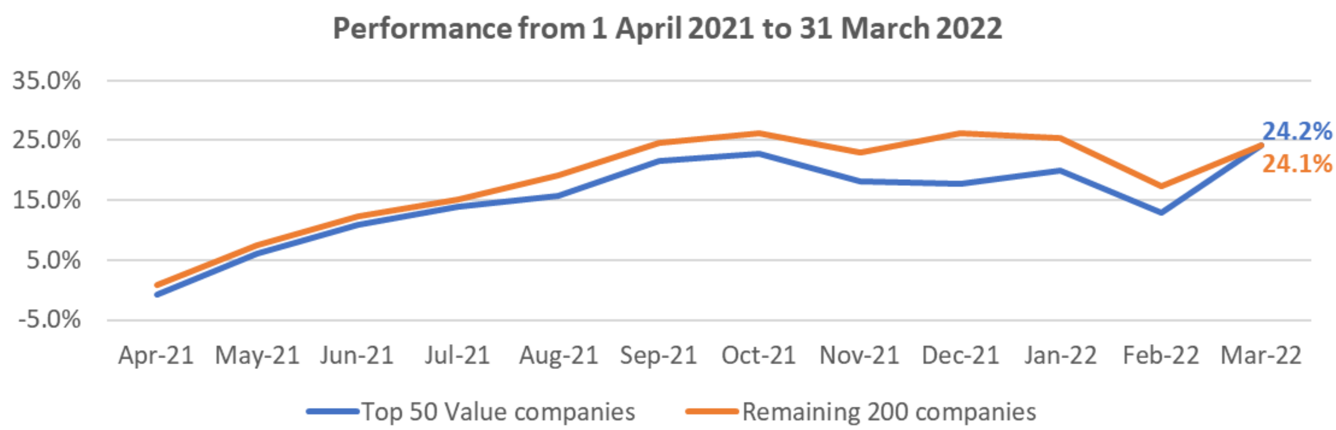
This shows that market penalized the profitability factor in latter half of this year.

4. Performance of value factor

Finally, we add a value parameter that helps us choose companies within the selection criteria available at relatively better prices. Let's review how the value factor has performed over the fund's lifetime.



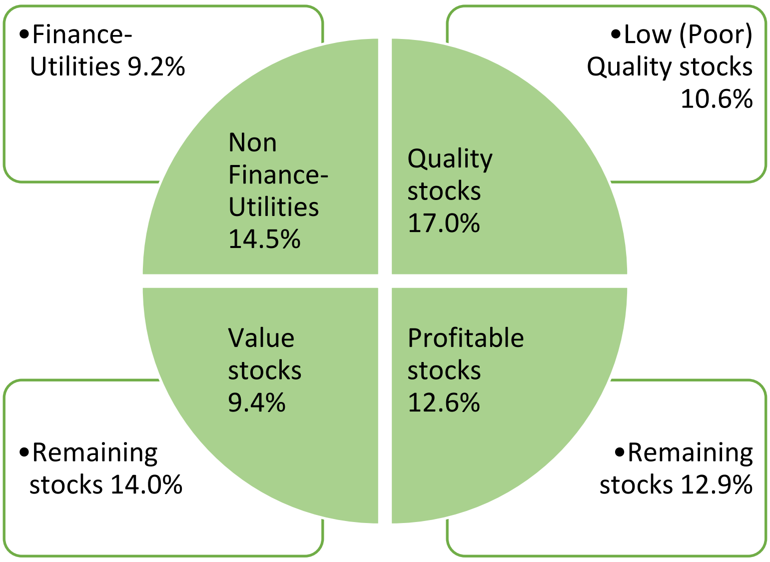
The value factor has in fact not worked since SIP's inception, and the performance of companies outside the value bucket is quite high as compared to the bucket classified as value. Has the value parameter worked this year?



The basket of top 50 value stocks lagged the remaining companies for almost all the review period, finally catching up in the last month, and surpassing the performance slightly. So, the value factor appears to have caught up with its initial underperformance and is performing at par with the non-value basket.

Summary of the factor-wise performance

Let's review the performance of all four factors at one go. The inner areas represent the performance of companies that pass each of the parameters, and their respective outer areas show the performance of the remaining companies.



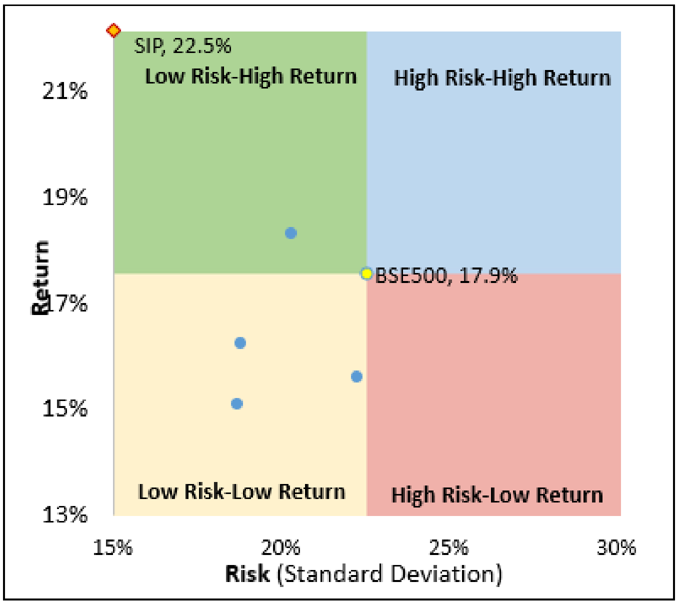
Key takeaways

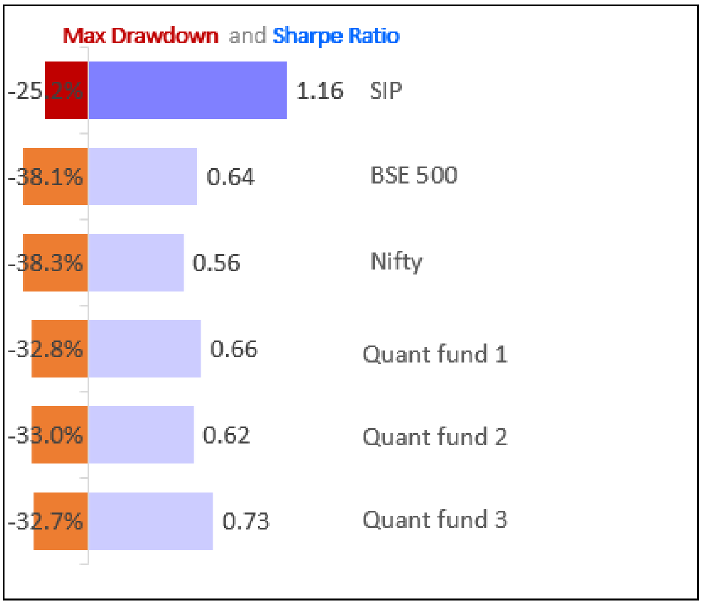
1. For SIP, not considering financials & utilities in its universe proved helpful to portfolio performance.
2. The Quality factor has worked in favour of SIP, with the quality stocks universe having a greater return than the low (poor) quality universe. In the recent year, though, low-quality companies have rallied more than quality ones.
3. The profitability factor worked for most part, but recently it was punished by the market, with top 50 profitable companies severely underperforming the remaining companies. Thus, the performance of most profitable companies is at par with the remaining companies.
4. Value factor hasn't worked over SIP's inception, with value stocks having lower returns than remaining stocks. At the end of the last fiscal year, value factor picked up to slightly exceed the performance of the remaining stocks.

Comparison with other quant funds (June 2019 to March 2022)

We have identified seven comparable quant funds in India which claim portfolios being constructed using a quantitative investment logic. All seven of these funds have been started after SIP's inception. Of these, we have compared the performance of SIP with three comparable quant funds which started in June 2019 or earlier.

We will see the positioning of SIP with the comparable funds as well as the indices in following chart/table.





On the left, the quadrant chart shows the relative position of each fund, considering their risk-return position as compared to the benchmark the BSE 500 index. SIP, with highest return and lowest risk lies at the top of the low risk-high return quadrant. Only one other quant fund lies in the same quadrant with significantly lower returns. The remaining two quant funds and Nifty index lie in the low risk-low return quadrant as compared to the BSE 500.

Another important criterion for an investor is the maximum drawdown – the worst return from crest to trough faced by the investment – and the Sharpe ratio (the excess return per additional unit of risk). Investors would want the investment to fall less from its peak, and to give highest excess return with least additional risk. The right-hand chart shows the maximum drawdowns and the Sharpe ratios for the SIP, all Quant funds, and indices under review. Here too, SIP stands out with lowest drawdown and highest Sharpe ratio.

Concluding remarks

Sankhya India Portfolio is designed to select the top 30 stocks that are most likely to perform the best over the next one year. Of the four building blocks of SIP, some may not perform at any given time. It is the combination of these four blocks that we have found works consistently well over most market conditions & regimes.

Regards,

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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 Sankhya India Portfolio was created on 17th October 2017. Performance has been compared with Total Return of the Index. For Sankhya India Portfolio Composite, blended benchmark of BSE 500 Total 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 SIP Composite includes all discretionary fee-paying portfolios that are being managed with the objective of is to invest in the companies that are highly probable to generate good returns based on back testing of the strategy. The selection of stocks will be from Large-cap and Mid-cap universe. Roughly the top 250 stocks based on market cap will be the candidates for the "Sankhya India Portfolio". 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.

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