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Moat & Special Situations Portfolio

Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (M&SSP) as of 31 Mar 2023.

Portfolio Performance [1]	Equity Allocation	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		13.5%	11.6%
Mar 2022 Quarter	67%	-4.8%	-5.2%
Financial Year 2023		2.4%	0.1%

We experienced a disappointing quarter as our portfolio corrected in line with the broader market, despite holding material cash. Our Life Insurance and Asset Management Company (AMC) exposures were the main contributors to the portfolio's decline, accounting for a significant -2.9% out of the total -4.8% decline during the quarter. We attribute this to regulatory changes affecting these sectors, which we have discussed in detail in later part of the letter.

But before we go to the portfolio specific discussion, we would like to talk about the current global macro backdrop. The collapse of Silicon Valley Bank and subsequent outflow of deposits from other regional US banks and the takeover of Credit Suisse by UBS, just as it teetered on the brink of collapse were the biggest global macro events since the Global Financial Crisis (GFC) of 2008. Both GFC and the current crisis can be traced back to the prevailing easy monetary policy environment that preceded them. But there are a few differences between GFC and the current crisis that we are going through.

The GFC was driven by poor quality underwriting of loans, particularly in the US mortgage market. This led to a build-up of risky loans and securities, which ultimately resulted in widespread defaults as the Housing market collapsed. Complex financial instruments and illiquidity of the underlying assets led to the contagion in the US financial market. On the other hand, the current crisis in US regional banks is driven by build-up of unrealized losses in the investment portfolio due to rising interest rates. As interest rates rise, the value of fixed-income securities held by banks decline, resulting in losses on these investments. Significant portion of the Assets of SVB were in the investment portfolio which saw build-up of unrealised losses. Outflow of deposits had to be funded by realising losses on the investment portfolio leading to further loss of confidence amongst depositors and negative virtuous cycle leading to the classic “run on bank” and eventual collapse of SVB. Collapse of SVB led to loss of confidence and eventual increase in outflow of deposits from other regional banks and in turn spreading the crisis.

Another key difference is the inflationary environment during the crisis. Inflationary environment during GFC was relatively benign, which allowed central banks globally to respond with aggressive monetary policy

[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.

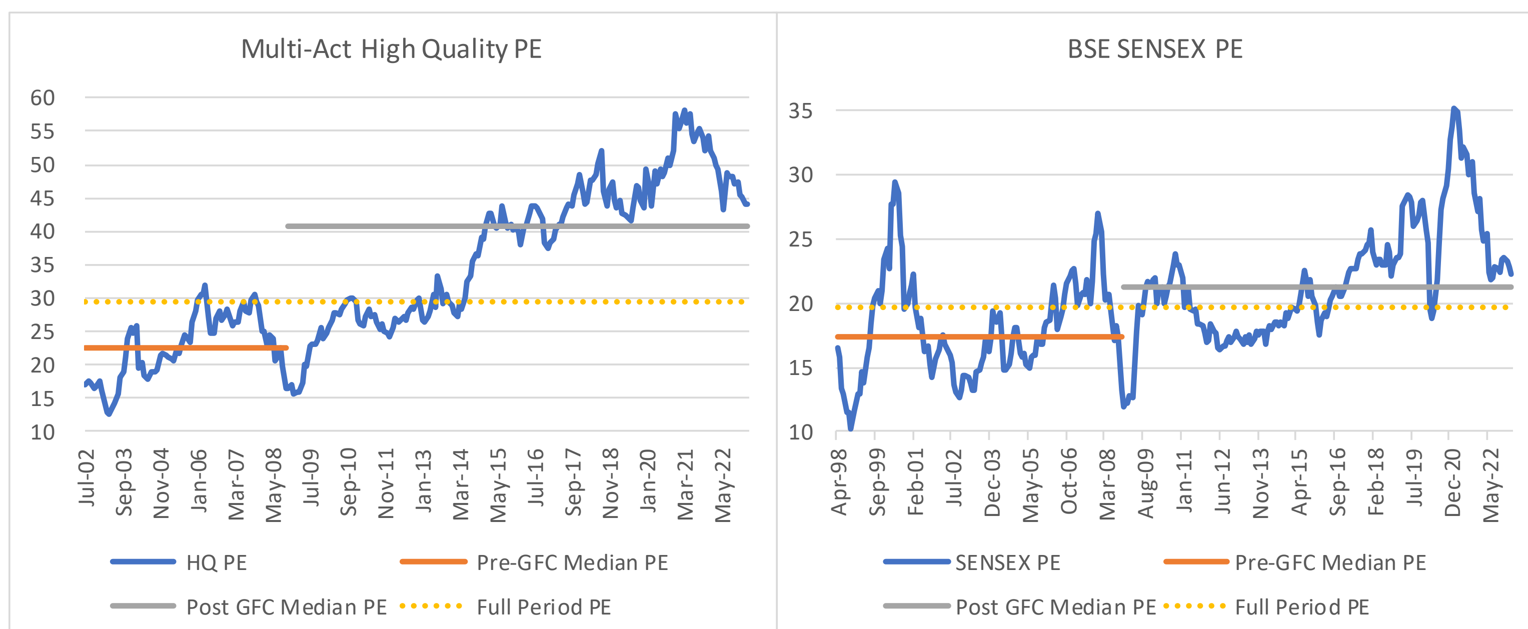
measures, including large-scale asset purchases (quantitative easing) and near-zero interest rates, to stimulate economic growth. In contrast, the current US regional banking crisis is occurring in an environment of higher inflation which is significantly above the stated target set by the US Federal Reserve. This restricts the ability of the US Fed to be accommodative.

One relatively positive outcome of this crisis has been the major shift in trajectory of interest rates that the market was factoring. Just before the collapse of SVB, market was building a higher peak in US Fed policy rates and reversal only in the next calendar year. After the collapse of SVB, the market started factoring lower peak and reversal in interest rates in the current year itself. But reversal of the cycle may not necessarily mean that we go back to close to zero interest rates unless we see a sharp drop in inflation going forward. Secondly, these global events may not have direct impact on India. Since RBI did not imitate the aggressive monetary policies followed by other global Central Banks during Covid, we are not witnessing the kind of negative impacts the reversal of these policies has triggered in those economies. Indian Banking system is far more resilient and much better placed despite the Banking crisis that we are witnessing globally. But the probability of recession in US has gone up, which would have an indirect impact on the Indian economy, especially on the export-oriented sectors.

How would the equity markets behave considering the differences in the two crises?

Post GFC, inflation was relatively low, allowing for ultraloose monetary policy and Quantitative Easing to counter macro shocks. As yields dropped and turned negative in some geographies, investors globally were forced to take disproportionate risk in search of yield. This led to valuation bubble across multiple asset classes which is now normalising.

In the post GFC period, we saw valuations getting inflated across the board, especially in the High Quality space (refer chart below).



There is a significant difference in valuations observed pre-GFC and post-GFC. Valuations continued to expand between 2011 and 2021. However, in the current inflationary environment, Central Banks may not be able to revert to ultra-loose monetary policy, despite the crisis. Even if there is some softening of inflation, returning to a zero or negative interest regime appears unlikely at this point in time. The question now is whether the inflated valuations of the post-GFC period can be used as a reliable guidepost for where valuations will prevail, or whether equity markets will revert to pre-GFC multiples. These

assumptions could lead to very different assessment of comfort in terms entry points for investors (refer table below).

Current PE % Away from	High Quality	SENSEX
Pre-GFC Median PE	-49%	-22%
Long Term Median PE	-33%	-11%
Post-GFC Median PE	-7%	-5%

Secondly, the tailwind of valuation rerating that helped boost equity returns over the last decade, would be difficult and we believe it would be a "stock pickers" market going forward. We are cognizant of this regime change that we are going through and are not anchored to valuation multiples of the recent past which may have been inflated. We have been waiting for our price points in the High Quality space in the last few years, which remained elusive (except during Covid crash). Valuations are now coming closer to our comfort zone in certain select pockets and may give us opportunity to add stocks in the portfolio if there is further correction/consolidation.

Asset Allocation

Our equity weights have reduced to 67% for older accounts. The drop in weights is due to exit in the Life Insurance sector exposure post the adverse budget announcement. For new accounts our initial weight is ~45%.

Portfolio Activity

Business Model Allocation	Jun-22	Sep-22	Dec-22	Mar-23
Moat	19%	16%	19%	14%
Limited Moat	53%	59%	60%	59%
Moat + Limited Moats	***72%***	***75%***	***79%***	***73%***
Special Situations	28%	25%	21%	27%
Regulated Utility	-	-	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**

Sector Allocation	Jun-22	Sep-22	Dec-22	Mar-23
Financials	29%	31%	29%	38%
Financial Services	21%	21%	28%	14%
FMCG	15%	14%	11%	14%
Information Technology	11%	10%	4%	10%
Pharma	4%	6%	6%	8%
Auto & Auto Ancillaries	6%	6%	11%	7%
Real Estate & Infrastructure	7%	5%	5%	5%
Capital Goods	5%	3%	3%	4%
Materials	3%	4%	3%	1%
Grand Total	**100%**	**100%**	**100%**	**100%**

We had discussed about our financial services allocation in the December quarter newsletter. The sector faced multiple negative developments during the quarter which impacted our Portfolio Performance.

Life Insurance:
The recent budget has made significant changes that will have a structural impact on the life insurance industry in our opinion.

The first change is that any incremental policy issued from next financial year to an individual, which leads to his cumulative annual premium to cross 5 lakhs, will have to pay tax on maturity of these incremental policies at his slab rate. Companies have estimated the impact of this change to be in low double digits in worst case. This impact assessment by companies is after looking at their exposure in isolation, and it is possible that an individual could have multiple policies from different insurance companies and could already have crossed the 5 Lakh premium limit. Thus, the affected business as reported by the companies could be relatively under-estimated. Our bigger concern is the growth trajectory of the business, as Insurance companies would have to keep on finding new buyers for these savings products as the existing client base who have already exhausted the limit, won't be available to contribute going forward (Client mining). Also, some clients will keep hitting the 5 lakh limit over the years, restricting growth from these clients and the need to find new clients for growth.

The second change is the proposed change to the income tax act, which will make the new tax regime without deductions more attractive than the existing tax regime with deductions. Insurance in India is largely a push product and the 80C deduction was one of the selling points to investors who were investing in these products. On average almost 35% of Insurance premium is collected in March quarter, which indicates the push due to tax deductions. The finance ministry has estimated that more than 50% of the tax payers would shift to new regime. It is difficult to assess the impact it would have on Life Insurance premium as of now and we would get more clarity by Q4 of next year.

Both these changes would alter the growth trajectory of the business and might have some impact on margins as well. The sector valuation multiples could de-rate considering accentuated regulatory risk as well as risk to underlying industry growth post these changes. Considering these risks and uncertainties, we felt these stocks may remain under pressure until clarity emerges on business impact and thus, we decided to exit from our position in the Life Insurance Industry. We had around 11% weight in Life Insurance sector. We would re-evaluate this space over the course of next financial year.

Asset Management Companies:
In the Case of Asset Management Companies (AMCs), the SEBI is planning to introduce certain changes to the Total Expense Ratio (TER), which is the revenue that AMCs generate on their AUM. While the exact changes are not released yet, based on the guiding principles articulated by SEBI, the proposed changes would be:

1. Inclusion of GST under TER. Currently TER does not include GST and is being charged separately. If the GST is included under TER, without increasing the TER cap, it would have a direct impact of upto 15% on Revenue of AMCs
2. Inclusion of brokerage in the TER. Currently brokerage charged on trades done by MFs is adjusted in the cost of the securities as long as it is less than 12 bps of AUM. By including brokerage in TER, AMCs will have to bear the cost. AMCs with higher churn ratio would be more impacted.
3. Scale based TER Caps at AMC level, rather than at Scheme level. This would have impact on larger AMCs.

Most AMCs have suggested that they would pass-on majority of the impact to the ecosystem – i.e. Distributors, Brokers and other intermediaries. But the ability to pass on the impact would depend on how competition behaves, especially in the case of scale based TER Caps, as the impact of that change would be disproportionately borne by larger AMCs. Until the final regulation specifying the TER Caps is released, it would be difficult to do a meaningful impact assessment. But the stocks have already reacted during the quarter to these proposed changes. We have not made any changes to our position in the AMCs at this point and would take a call post the final changes are released and once we are able to assess the impact.

Regards,

Rohan Samant	Rohan Advant	Akshat Hariya
CIO	**Sr. PM & Associate Director**	**Assistant Portfolio Manager**

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 2022 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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