

## Why are we content with our portfolio performance?

Our last 3-year (Jul-16 to Jun-19) performance was 9.5% CAGR versus Nifty's performance of 14.5%. We consider 3-year period as bare minimum for comparing performance with benchmark since we practice long term fundamental investing.

Now one may ask are we happy with our performance despite lagging Nifty's performance? We wish to highlight few circumstances under which our performance will appear very good.

- 1) **Expensive Markets:** Markets have been expensive for last 5 years. Nifty gained 7% CAGR as against profit growth of meagre 2% CAGR from Mar-14 to Mar-19. Following image shows Nifty P/E ratio has been in expensive territory for prolonged period never seen before. Although this doesn't mean that expensive market lead to immediate correction but what it means is investing at expensive level yields very poor returns in medium to long term.



Because markets were expensive, we didn't find many investment opportunities. We were forced to recommend liquid funds while rest of the market participants were dabbling into riskier stocks in pursuit of higher returns.

Our liquid fund position has been hovering around 30-50% over last 3 years. This was extraordinarily high due to elevated market conditions. Now let us see whether having liquid funds was a good decision in Jun'16.

In the listed space of around, 75% of stocks have earned less than 6% CAGR our liquid fund position over last 3 years. This indicates that it was wise not to be in fully and save losses rather than be adventurous in buying those risky stocks which have turned into duds.

The main reason for expensive valuation was flow of money from FIIs and DIIs in search of returns due to poor returns in other assets eg. Fixed income, real estate, gold, etc.

- 2) **Nifty's polarized performance:** There is very atypical rally in handful of stocks while rest of the markets were crumbling. Usually latching onto couple of stocks happens during times of uncertainty when these stocks are perceived to be "safe stocks" temporarily. Following stocks have been rising while rest of the market is down. IT stocks- TCS, Infy; Banks – Axis, ICICI, Kotak, HDFC Bank; NBFC – HDFC, Baj Finance; FMCG – HUL, Asian Paints; & RIL.

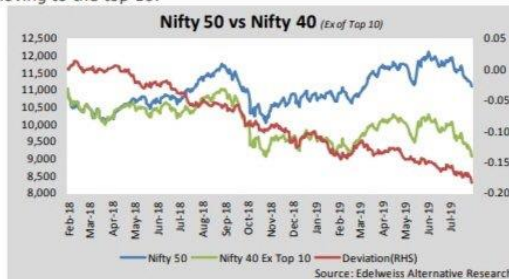
Here is one of the interesting studies done by Edelweiss AMC on Nifty 40 i.e. stocks other than above 10 stocks.

## Edelweiss Vital Insights



### How does Nifty 40 look like? Nifty 50 @ 11000 vs Nifty 40 @ 9000

- The top 10 heavy weighted stocks of Nifty have not changed much\* in the past one and half years. What has changed is their correlation with the rest of the 40 names. Since Jan-18, the top 10 market cap companies have gained ~21.4% where as the rest 40 companies market cap is down by ~14.6%.
- Nifty 50 components have largely moved in sync till the first half of CY18 but in last one year, a notable change has been seen between the top 10 vs the rest 40 performance wise. An Index created by the rest 40 currently stands at 9000 levels while the Nifty 50 stocks index is at 11000 levels. The deviation is much wider if we look at the Nifty Midcap 100 and Nifty Small cap 100 Index.
- Since Jan-18 till date, Nifty 50 is still in the green with a 6% return but Midcap is down by 26% and Small cap is bleeding down 39%. The underperformance of Mid and Small Cap started post the announcement of introduction of Long Term capital Gain Tax in the Feb-18 budget which has till date not stabilised.
- The Large caps still were holding on just before the announcement of introduction of super rich tax in the Jul-19 budget after which the Large caps too have witnessed sell off. The fall has been majorly driven by the FPI outflows with FPIs selling \$2.5bn in secondary market in July. On the opposite side, DIIs have been buying to the tune of \$ 2.4bn.
- Theory of mean revision suggest a reverse of the deviation but looks like the top 10 to converge with the rest 40 rather than the rest 40 moving to the top 10.

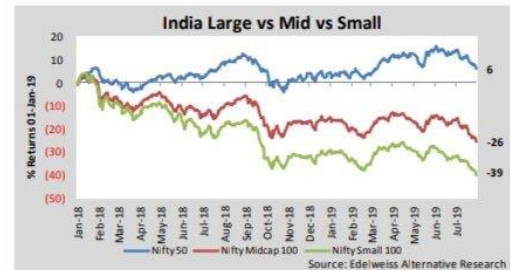


\*MARUTI has moved from 10th ranking to 13th ranking & Axis Bank has entered as 10th ranker

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Source: Edelweiss Alternative Research

31-Jul-19

Edelweiss Vital Insights

If one sees Nifty 40, it would trade at 9000 versus Nifty's 50 11,000 level. Starting Mar-18, top 10 stocks have gained ~21.4% versus rest of the 40 companies that are down ~14.6%.

Another study done by Motilal Oswal Group shows how Top 10 stocks have dominated mutual fund portfolios. One of the reasons for this movement also has been due to [constant inflows of EPFO money](#) into Sensex and Nifty.

Luckily only those funds who copy/mimic indices have earned comparable returns. Rest of the time, these funds are worth avoiding as they have much lower chance to beat indices. Rest of the funds have been underperforming Nifty over 3 year period.

MF exposure in top-10 Nifty stocks by weight (%)



In last 18 months, Nifty has managed to be within 10% from its peak. Rest of the funds/retail investors are staring at deeper losses. In such circumstances, we believe we have fared much better thanks to 30-40% allocation to Liquid funds.

- 3) **Sticking to process:** At MoneyWorks4me we stick to an investment philosophy. We buy when equities are cheap and sell when they are expensive. At times when they are not cheap, we prefer to remain in liquid funds as chances of losing money are more than making money. As evident by stock performance since Jul-16, holding liquid funds turned out to be right even if momentarily one would have felt that we missed 2017 rally. This rally was entirely given up in 2018-19. For our process to work, correction and rebound is absolutely necessary. Since there was no volatility in period until late 2018, we couldn't deploy funds in stocks at discounted prices. It is only now in last 10 months that we are able to invest heavily. As the market rebounds we will sweep through benchmark performance.

The outcome is known only in hindsight, but an advisor's expertise can be judged looking back at how he was positioned before the adversity hit. Since we didn't find many opportunities to invest, we parked around 30-50% of our clients' funds in liquid funds. While it was certainly a drag on returns initially, but we didn't take undue risks to chase short term returns. We have come across several market participants who have lost many in 2018-19 and gave up all the returns earned in the period 2014-17.

We remain committed to our philosophy and once again proved that our customers can manage a larger percentage of their network with this style of investing.

When rest of the market who are disappointed that they didn't set aside cash, we are excited to pick bargains on the street. As per our estimates, our portfolio potential upside is more than 13% CAGR over 3 years including liquid funds and 15%+ on invested portion.

Now you may ask, "Ok. We agree that your performance was fine. But what about desired rate of return in equity. How will we reach closer to that? Aren't equity supposed to deliver 7%+ returns over inflation?". We will write a separate blog for that. Keep watching this space.