MONTHLY Communique

MOTILAL OSWAL ASSET MANAGEMENT

BUY RIGHT SIT TIGHT

August, 2017

When will we get a correction?

At a recent business partner conference organised by our parent company – Motilal Oswal Securities – I was moderating a panel discussion with highly respected CIOs of the asset management industry. One of the CIOs asked the audience full of distributors, investment advisors, equity traders and consultants this question: "How many of your clients are waiting for a correction so that they may invest"? In an audience of about 700 people, almost everyone raised their hand – some with their arm extended enthusiastically, some with their arm half raised the way most audiences do and some with their elbow firmly grounded on the table – but yes everyone seems to be waiting for a correction to invest. I can imagine that 700 business partners managing a few thousands clients may not be sample enough for me to draw any conclusion, but you could substantiate my observation further by reading newspapers, tracking social media discourse (I am on twitter, facebook and linkedin – and I can tell you this is the most hated rally as far as SM mavens are concerned), watching business news or speaking to some of your "clued-on" friends.

So much so that the mutual fund industry that manages about 6 lac crs of assets as per my estimate has anywhere between 75,000 to 85,000 crs in cash, cash equivalents, short term debt or equity with corresponding short positions (hedged to neutralise long equity). Most of this money by construct is destined to get into equity at every fall in the market. Further, we are witnessing anywhere between Rs. 15,000 to Rs. 20,000 crs of net inflows into equity and balanced funds every month (Source: Association of Mutual Funds in India, monthly industry data publication). It is worth noting here that apart from equity mutual funds, we have private insurance companies, the LIC of India, alternative funds, domestic retail equity investors and multiple other investor categories but it is well known that currently only domestic funds are buying and others aren't firing as much. The current state of affairs is very elegantly explained as a liquidity driven rally but that to me is a first order lazy explanation because it's not like liquidity is at gun-point. Indians are known to have preferred fixed income investments, land, houses, gold, and similar other investment options. Further, a dramatic decline in interest rates and inflation elevates valuations naturally as discounting rates decline and from there on one must be attuned to living with higher index levels, higher valuations and correspondingly lower nominal returns.

Limited point, you don't get a correction only because everyone is wishing for it, waiting for it, asking for it, threatening for it...or even praying for it! You don't even get a correction just because you see index at all-time highs or valuations above average.

I have no agenda in the for-correction or against-correction debate, as a house, we do not take cash calls in our equity portfolios, at all times we are committed to running a "best-ideas" portfolio where we think on a weighted average basis the earnings in the portfolio can double in every 3-4 years on a sustainable basis (high quality-high growth with longevity) and ensuring that relative to market our portfolios are at reasonable valuations. Yes, we do manage a Dynamic Equity Fund where we are committed to calibrating the equity exposure in response to market valuations as signified by our proprietary Motilal Oswal Value Index – and that fund currently has just about 40%-45% long equity exposure; in line with what I argued above. Rest assured, the asset allocation of this fund will be managed systematically and it won't be impacted by any opinions or arguments I am sharing here.

On the "for correction" side of the debate are number of arguments – one of the strong ones being possibility of some kind of global challenge emerging out of US (Fed actions) or China (increasing rumblings about glossing over very bad macros). This will always be a strong threat but any kind of international turmoil resulting in selling in our markets and hence a decline in our markets has in hindsight proved to be a strong buying opportunity. So, we all should be the happiest if we get the much-awaited correction in

(Continued overleaf)

response to some international bad news. That would mean we get a much awaited entry point without any serious local economic concerns. There are domestic fears related to how GST impact will play out, how is the rural economy actually faring, NPAs in banks and troubled corporate sector, slowdown in IT, sluggish exports etc etc. Clearly the earnings growth and dispersion of earnings is skewed in favour of select sectors namely private sector banks, broader financial services like mortgage and consumer NBFCs, insurance, asset management, consumer discretionary like white goods, autos, building materials etc. There is also a rebound in select commodities and metals. There are some excellent new listings that have already happened and more likely around the corner which also presents us with growth oriented investment opportunities, absorbs supply and to that extent can contribute to evening out valuations.

It is worth noting that market has made new highs nearing around 8900-9200 multiple times in the last 3 years and each time the market has retraced in response to earnings disappointments emanating out of unknowns – RBIs asset quality review for banks and ensuing in NPA recognition, Chinese devaluation and commodity collapse, the Trump election and demonetisation and finally GST implementation…Each time the market was primed for an up move some such setback to earnings has spoilt the party. With this recent past experience, if we assume that each time the market goes up, earnings will continue to disappoint, we will eventually be proven wrong. Corporate Profits as a proportion of GDP have touched an all time low of 2.9% as at end FY17 (Source: MOSL Research). Many indicators point to the beginning of a mean reversion on this front and eventually there will be a few quarters or a year or two years or significantly higher earnings growth in the near future and staying out of the market when other asset classes are returning poorly is a bad choice. It will be ideal to remain invested on existing holdings and add further investments by way of dynamic strategies, systematic transfers or staggered entry at regular intervals.

Happy Investing,

Yours Sincerely,
Aashish P Somaiyaa
Managing Director and CEO

Value Strategy

Strategy Objective

The Strategy aims to benefit from the long term compounding effect on investments done in good businesses, run by great business managers for superior wealth creation.

Investment Strategy

- Value based stock selection
- Investment Approach: Buy & Hold
- Investments with Long term perspective
- Maximize post tax return due to Low Churn

Details

Fund Manager	:	Manish Sonthalia
Co-fund Manager	:	Kunal Jadhwani
Strategy Type	:	Open ended
Date of Inception	:	24th March 2003
Benchmark	:	Nifty 50 Index
Investment Horizon	:	3 Years +
Subscription	:	Daily
Redemption	:	Daily
Valuation Point	:	Daily

Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	35.77
Auto & Auto Ancillaries	27.04
Oil and Gas	8.13
FMCG	7.00
Airlines	6.07
Pharmaceuticals	5.34
Infotech	5.11
Engineering & Electricals	5.09
Cash	0.45

Data as on 31st July 2017 *Above 5% & Cash

Top 10 Holdings

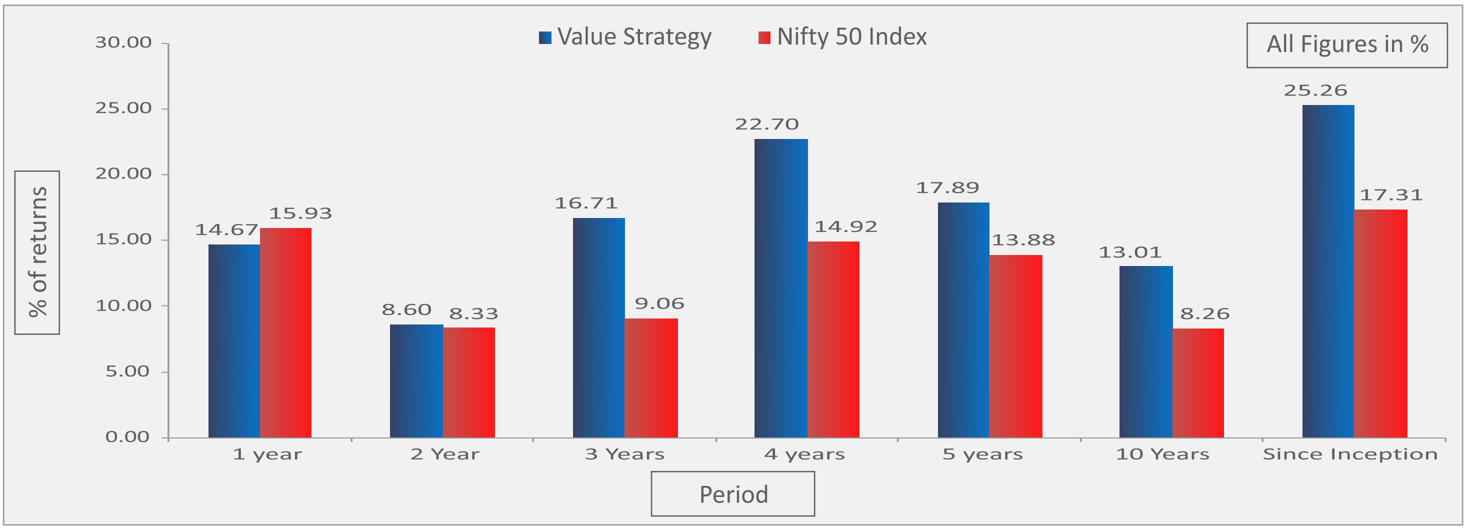
Particulars	% Allocation
HDFC Bank Ltd.	12.33
Kotak Mahindra Bank Ltd.	10.83
Eicher Motors Ltd.	8.54
Bosch Ltd.	8.39
Bharat Petroleum Corporation. Ltd.	8.13
Asian Paints Ltd.	7.00
Housing Development Finance Corporation Ltd.	6.61
Interglobe Aviation Ltd.	6.07
AU Small Finance Bank Ltd.	6.00
Sun Pharmaceuticals Ltd.	5.34

Data as on 31st July 2017

Key Portfolio Analysis

Performance Data (Since Inception)	Value Strategy	Nifty 50
Standard Deviation (%)	21.04%	23.32%
Beta	0.82	1.00

Data as on 31st July 2017



The Above strategy returns are of a Model Client. Returns of individual clients may differ depending on factors such as time of entry/exit/ additional inflows in the strategy. The Above returns are calculated on NAV basis and are based on the closing market prices as on 31st July 2017. Past performance may or may not be sustained in future. Returns above 1 year are annualized. Please refer to the disclosure document for further information.

Next Trillion Dollar Opportunity Strategy

Strategy Objective

The Strategy aims to deliver superior returns by investing in stocks from sectors that can benefit from the Next Trillion Dollar GDP growth.

It aims to predominantly invest in Small and Mid Cap stocks with a focus on identifying potential winners that would participate in successive phases of GDP growth.

Investment Strategy

- Stocks with Reasonable Valuation
- Concentration on Emerging Themes
- Buy & Hold Strategy

Details

Fund Manager	: Manish Sonthalia
Strategy Type	: Open ended
Date of Inception	: 11th December 2007
Benchmark	: Nifty Free Float Midcap 100 Index
Investment Horizon	: 3 Years +
Subscription	: Daily
Redemption	: Daily
Valuation Point	: Daily

Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	34.79
Auto & Auto Ancillaries	16.44
FMCG	14.43
Diversified	13.13
Oil and Gas	6.23
Cash	0.06

Data as on 31st July 2017 *Above 5% & Cash

Top 10 Holdings

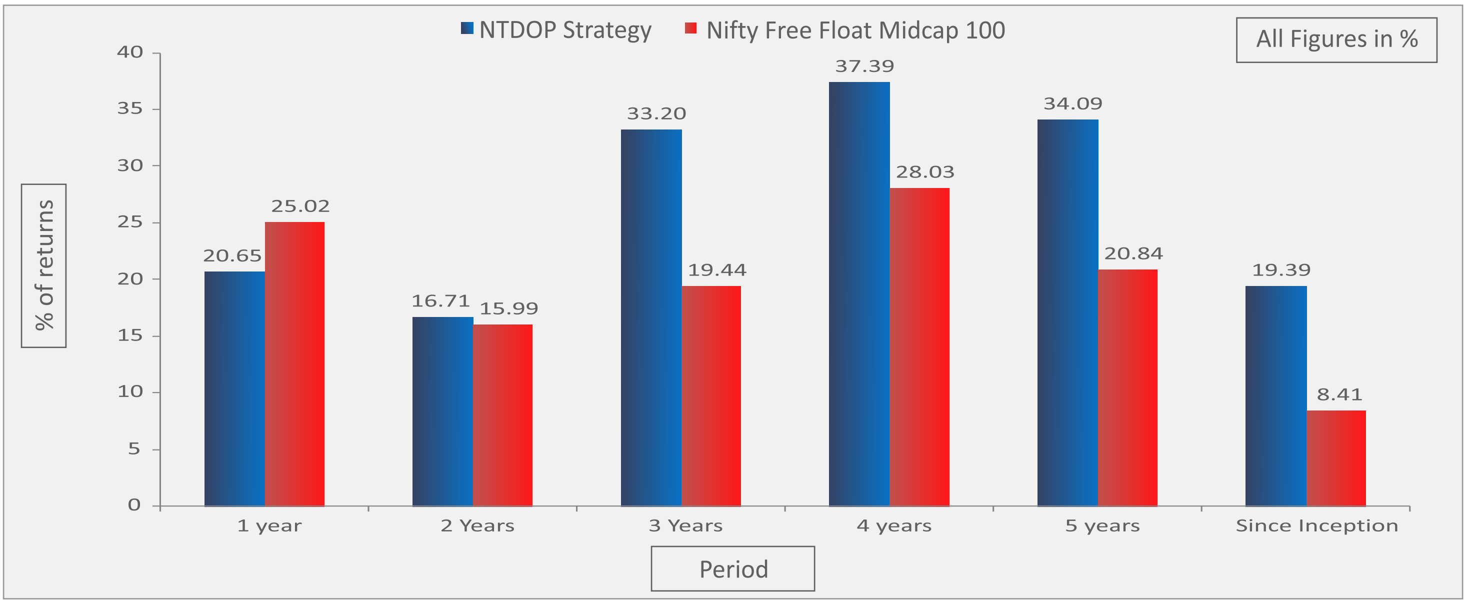
Particulars	% Allocation
Kotak Mahindra Bank Ltd.	11.27
Bajaj Finance Ltd.	8.76
Voltas Ltd.	8.30
Eicher Motors Ltd.	7.20
Page Industries Ltd.	6.77
Bosch Ltd.	5.93
Max Financial Services Ltd.	5.57
Godrej Industries Ltd.	4.82
City Union Bank Ltd.	4.72
Hindustan Petroleum Corporation Ltd.	4.12

Data as on 31st July 2017

Key Portfolio Analysis

Performance Data (Since Inception)	NTDOP	Nifty Free Float Midcap 100
Standard Deviation (%)	18.28%	22.23%
Beta	0.71	1.00

Data as on 31st July 2017



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India Opportunity Portfolio Strategy

Strategy Objective

The Strategy aims to generate long term capital appreciation by creating a focused portfolio of high growth stocks having the potential to grow more than the nominal GDP for next 5-7 years across market capitalization and which are available at reasonable market prices.

Investment Strategy

- Buy Growth Stocks across Market capitalization which have the potential to grow at 1.5 times the nominal GDP for next 5-7 years.
- BUY & HOLD strategy, leading to low to medium churn thereby enhancing post-tax returns

Details

Fund Manager	: Mr. Manish Sonthalia
Co-Fund Manager	: Ms. Mythili Balakrishnan
Strategy Type	: Open ended
Date of Inception	: 11th Feb. 2010
Benchmark	: Nifty Free Float Midcap 100
Investment Horizon	: 3 Years +
Subscription	: Daily
Redemption	: Daily
Valuation Point	: Daily

Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	30.56
Cement & Infrastructure	12.02
Oil and Gas	11.66
Consumer Durable	10.42
Pharmaceuticals	9.97
Auto & Auto Ancillaries	8.88
Services	7.15
Cash	0.60

Data as on 31st July 2017 *Above 5% & Cash

Top 10 Holdings

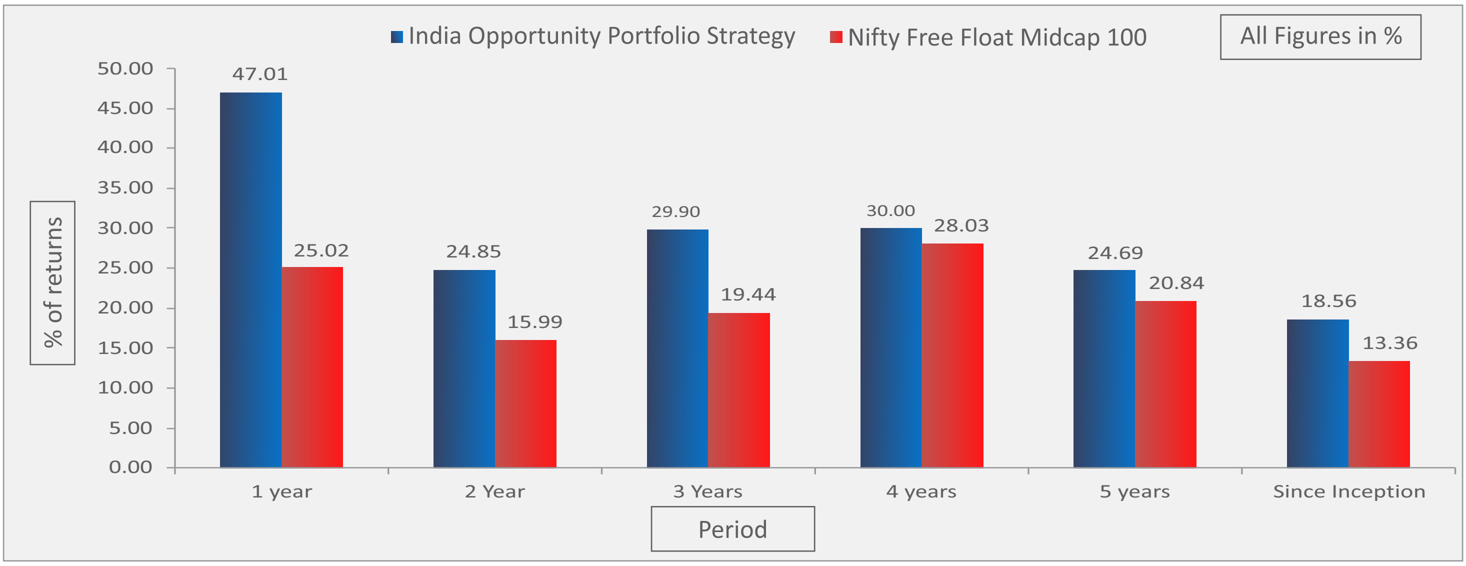
Particulars	% Allocation
Development Credit Bank Ltd.	10.21
Birla Corporation Ltd.	8.87
Canfin Homes Ltd.	7.18
Quess Corporation Ltd.	7.15
Aegis Logistics Ltd.	6.48
AU Small Finance Bank Ltd.	6.28
Gabriel India Ltd.	5.89
TTK Prestige Ltd.	5.24
Mahanagar Gas Ltd.	5.18
Kajaria Ceramics Ltd.	5.18

Data as on 31st July 2017

Key Portfolio Analysis

Performance Data (Since Inception)	IOPS	Nifty Free Float Midcap 100
Standard Deviation (%)	15.39%	16.99%
Beta	0.75	1.00

Data as on 31st July 2017



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