

MONTHLY Communique

May 2016



Dear Investors and my dear Advisor friends,

This month instead of writing a newsletter to you, I am taking the liberty of reproducing (with permission), the extracts of an interesting blog written by Mr Dev Ashish of StableInvestor. You may use the link <http://www.stableinvestor.com/2015/12/investing-in-india-large-cap-stocks.html?m=1> to access the article. I find it extremely useful and I believe it would serve as very interesting reading.

“For a moment, let's keep aside the discussion of investing in large-cap stocks and dedicate next few sentences to the over-glamorized concept of ‘Thinking outside the box’. As per generally agreed definition, thinking outside the box is a metaphor that means to think differently, unconventionally, or from a new perspective. This phrase often refers to novel or creative thinking.

Now you will agree with me that even referring to this phrase makes one sound smart. Even though it is not at all easy and infact, a grossly misunderstood concept.

Now lets come back to what this website is about – **Investing + Common Sense.**

It is a commonly held notion that one needs to do something out of the ordinary, to find multibagger stocks. For example being able to correctly predict a sector's rise in future, correctly predicting a company's turn around, correctly predicting Fed rate cuts and how it impacts investors, etc.

To an extent, it's true. When investing, it does auger well for an investor if he can look outside the box and correctly identify change in trends, businesses, demands, etc.

But when markets continue to do well, market participants (lets ignore whether they are investors or traders) need to increase their efforts to find their next investment thesis. Why is an increase in efforts required? It is because due to rise in markets, good investment opportunities become hard to find.

Now by definition, good investment ideas are rare. So one essentially needs to look in unexplored pockets of stock markets to find good investment worthy stocks. This works well for really good analysts and investors.

But when this trend of finding multibaggers catches the fancy of common investors (who might get attracted to terms like value investing, moat investing, special situations investing, etc.), I feel that the possibility of stocks of well established, large-cap companies getting ignored and falling off the radar, increases.

What I am saying is that when everyone is looking outside the box, it might be a good idea to turn around and look into the box again. Its because there is a good chance that there might be a few good, investment worthy stocks, lying there in plain sight.

To be more specific, it's possible that when you are looking for the next multibagger among small-caps and other exotic stocks (outside the box), some seriously undervalued stocks might be available in the large-cap space (inside the box).

I was reading an article by John Huber of Saber Capital Management (Base Hit Investing), where he talks about why stocks get mispriced in general. Here is what he had to say, especially about large-caps:

Large caps stocks that get mispriced are almost always due to disgust. These stocks are large companies that are widely followed by investors and analysts. There is very little information that is not widely known by all market participants. However, sometimes these large companies run into a temporary problem and investors sell the stock because the outlook for the next quarter or the next year is poor. Investors can take advantage of this situation by a) accurately analyzing the situation and determining that the nature of the problem is in fact temporary and fixable, and b) be willing to hold the stock for 2 or 3 years—a timeframe that most individual and institutional investors are not willing to participate in.

Some investors refer to this concept as “time arbitrage”. It just means that you're willing to look out further than most investors and willing to deal with near term volatility and negative (but temporary) short-term business results.

In addition to a company specific “disgust”, these large caps can also get beaten down when the general market environment is pessimistic. In bear markets, companies with no problems at all often see their stock prices get beaten down because of macroeconomic worries or general market pessimism.

So although many value investors look at small caps because they feel this is where they can gain an informational advantage, I think taking advantage of this “disgust” factor is just as effective and is an important arrow to have in the quiver.

These are some really wise words for common investors, looking to build their own direct stock portfolio, in addition to mutual funds portfolio (highly recommended thing to do).

What John is trying to say is that as a common investor, it's really tough to find the next set of multibaggers (especially in small-cap universe). Common investors by definition do not have the time or the skill to correctly analyse real businesses behind stocks. And honestly speaking, the best they end up doing is to get a tip from here and there, and invest their money, hoping to be right.

Sometimes, it works. But most of the times, it doesn't.

It can work beautifully in Bull markets as a rising tide lifts all boats. But it can cause big losses when Bulls give way to Bears.

Think about it. When almost everyone is ignoring large cap stocks and looking in the mid-cap and small-cap universe, isn't it possible that some good, solid and established businesses might be available at throwaway prices? I think, its possible.

A common investor's best bet when dealing with stock markets, is to use their Common Sense.

So read the paragraphs by John (italicized above) again. Don't ignore large-cap stocks just because everyone else is saying that they don't move much. Apart from focusing on upsides, its also very important to protect the downsides when investing. And large caps can help you do that. They generally don't fall as sharply as most small-caps."

Thanks to Dev Ashish, hope you found this article interesting.

Since, I personally meet hundreds of investors every month; I would like to share my own experience in relation to investing in large caps and investors' attitude towards large caps. It is widely felt by investors that large companies have already "run up", and how much more return can they make??? Now that belief needs some serious questioning.

Some of the best performing large cap stocks we have are private sector banks. Investors usually find these stocks have already "run up" and they feel that their fund managers should look for the "next big bank" rather than buying the one that has "already become big". I don't know from which perspective one can conclude anything has run its course already in a country where the Prime Minister has to make a personal agenda to ensure people open bank accounts and subscribe to insurance policies!!! I don't know what Prime Ministers in other developing nations do, but I know in our country he ensures people open bank accounts and then lo and behold some 15 cr people open accounts and deposit some Rs 30,000 crs into those accounts. Wow, God bless us if we think the private banks are done and dusted with!!!

The other such refrain I have heard is about mortgage firms having run up a lot in the last 3-5 years. On one hand the oldest and largest mortgage company has been amongst the biggest wealth creators, been in business for just under 50 years, over 2 lac crs balance sheet etc etc. The stock has already "run up" quite a lot. But what will you conclude if I tell you that in the last 18 months more than 20 mortgage companies have taken a license from the National Housing Bank to commence operations in mortgage financing!!!

And finally I would like to share some interesting statistics from the latest Wealth Creation Study written by our Chairman, Raamdeo Agrawal.

Mini, Mid, Mega crossovers - 2000-05,2005-10,2010-15

Note: Figure in brackets indicate number of companies

2000-05: Median return CAGR				2005-10: Median return CAGR				2010-15: Median return CAGR						
Market return : 5%				Market return : 22%				Market return : 10%						
To	Mega	158% (1)	55% (17)	21% (59)	To	Mega	76% (2)	46% (9)	27% (66)	To	Mega	68% (3)	33% (24)	11% (71)
	Mid	57% (58)	21% (90)	-4% (28)		Mid	61% (25)	24% (89)	9% (32)		Mid	38% (64)	9% (88)	-13% (26)
	Mini	19% (1,039)	-3% (93)	-40% (13)		Mini	11% (1,465)	4% (102)	-32% (3)		Mini	0% (1,841)	-19% (88)	-32% (3)

Source: <http://www.motilaloswal.com/site/rreports/635857020734161070.pdf>

The table above shows how different buckets of market cap have behaved in consecutive 5 year periods. Lets focus on the latest one i.e. 2010-2015, the third grid on the right of the picture. Just for clarity mega means large cap stocks i.e. those stocks that are in the top 100 listed companies by market cap (i.e. market cap greater than Rs. 18,700Cr.), mid cap is stock no. 101 to 300 by market cap ranks (i.e. market cap above Rs. 3,800 Cr.) and mini (small) cap are stocks that are smaller by market cap than the 300th stock in the market cap ranks (i.e. market cap less than Rs. 3,800 Cr.)
Note: Market Cap data as on 18th April 2016.

The grid says that in the entire universe there were 1,908 mini cap stocks, 200 mid cap stocks and 100 large cap stocks. Over the 5 years period of 2010 to 2015 – 64 mini cap stocks grew to become midcap and only 3 minicap stocks grew to become mega cap generating 38% CAGR and 68% CAGR respectively. The rest of the companies cumulatively remained mini cap and generated NIL return on CAGR basis. As you will realize it is 64 out of 1,908 and 3 out of 200 – probability of 3% success that a mini cap becomes a mid cap and probability of 0.1% that a mini cap becomes a large cap. The potential return is high but odds are heavily against creating wealth.

If you analyze the transition from mid cap to mega cap there are 24 out of 200 companies that grew to become mega cap with a CAGR of 33%, 88 companies remained mid cap with a CAGR of 9% and another 88 companies actually destroyed value turning into mini cap in 5 years delivering a negative 19% CAGR. That's a 12% probability of creating some wealth.

Lastly have a look at what happened to the 100 mega cap stocks at the starting in 2010. A full 71 of them remained to be mega cap delivering a CAGR of 11%. This 11% CAGR doesn't look exciting at all but don't forget the important lesson in all this data is of probability of success. There is 71% probability the company will remain mega cap and deliver a positive return. If the average return is 11% that too with 71% probability of success, it is also highly probable that you will end up owning a company that did much more than 11% on CAGR basis, after all 11% is average return of 71% companies because some would have delivered 0 and some would have delivered over 20% while all of them remaining to be leaders. On the other hand, the chance of failure or destruction in wealth reduces to 29% with only a 3% chance of a mega cap company crashing to mini cap.

We at Motilal Oswal AMC manage all caps of funds and hence I have no favorites or agenda in highlighting one over the other. My agenda is only to highlight possibilities and perceptions that I notice in the investors' process of making investment decisions. Just for your information MOST Focused 25 is our large cap Mutual Fund and Value PMS is our large cap PMS. Please consult your investment advisor for any further information or details that you may require or feel free to write back to me aashishps@motilaloswal.com.

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
 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*
Auto & Auto Ancillaries	29.37
Banking & Finance	24.09
Pharmaceuticals	10.77
Oil and Gas	7.62
FMCG	6.61
Infotech	6.59
Airlines	6.41
Cash	0.14

Data as on 30th April 2016

*Above 5% & Cash

Top Holdings

Particulars	% Allocation*
Eicher Motors Ltd.	11.21
Sun Pharmaceuticals Ltd.	10.77
Bosch Ltd.	8.65
HDFC Bank Ltd.	8.28
Bharat Petroleum Corpn. Ltd	7.62
Asian Paints Ltd.	6.61
Tata Consultancy Services Ltd.	6.59
Kotak Mahindra Bank Ltd.	6.45
Interglobe Aviation Ltd.	6.41

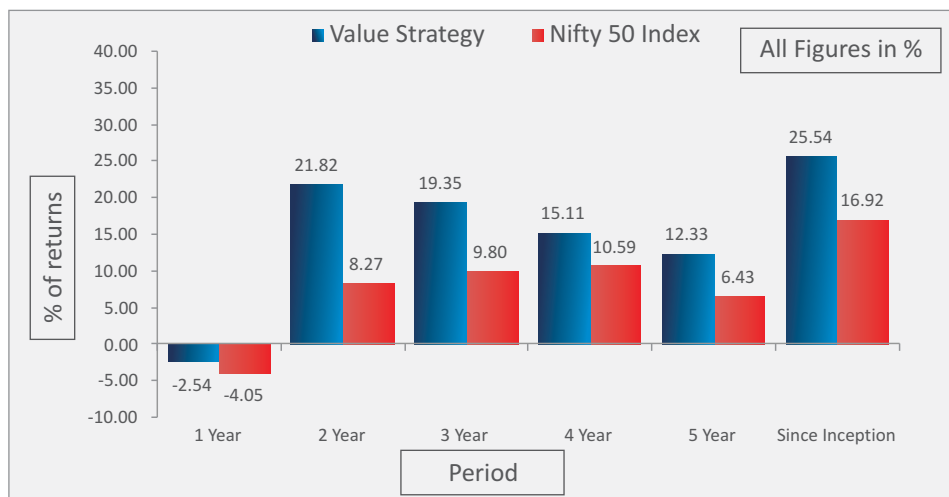
Data as on 30th April 2016

*Above 5%

Key Portfolio Analysis

Performance Data	Value Strategy	Nifty 50
Standard Deviation (%)	21.27	23.67
Beta	0.81	1.00

Data as on 30th April 2016



Data as on 30th April 2016

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 30th April 2016. 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 Dec. 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	30.46
Auto & Auto Ancillaries	21.85
FMCG	17.05
Oil and Gas	11.55
Diversified	6.36
Engineering & Electricals	5.68

Data as on 30th April 2016

*Above 5% & Cash

Top Holdings

Particulars	% Allocation*
Bajaj Finance Ltd.	14.01
Eicher Motors Ltd.	12.31
Hindustan Petroleum Corporation Ltd.	11.55
Page Industries Ltd.	8.34
Bosch Ltd.	7.02
Voltas Ltd.	6.36
Kotak Mahindra Bank Ltd.	5.94
Max Financial Services Ltd.	5.43

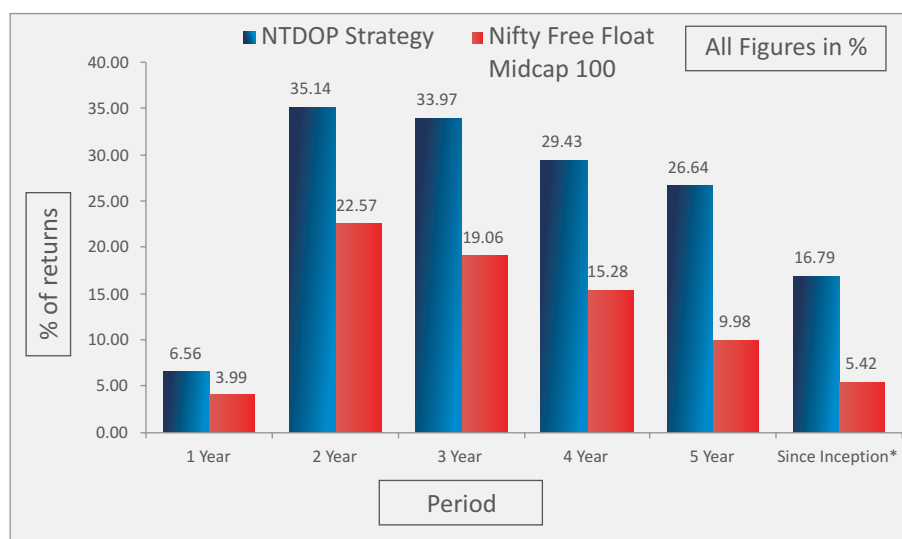
Data as on 30th April 2016

*Above 5%

Key Portfolio Analysis

Performance Data	NTDOP	Nifty Free Float Midcap 100
Standard Deviation (%)	18.31	22.68
Beta	0.70	1.00

Data as on 30th April 2016



Data as on 30th April 2016

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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 : Varun Goel
Strategy Type : Open ended
Date of Inception : 11th Feb. 2010
Benchmark : BSE 200
Investment Horizon : 3 Years +
Subscription : Daily
Redemption : Daily
Valuation Point : Daily

Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	29.24
Auto & Auto Ancillaries	17.07
Pharmaceuticals	14.96
Oil and Gas	11.39
Airlines	7.39
Cash	0.30

Data as on 30th April 2016

*Above 5% & Cash

Top Holdings

Particulars	% Allocation*
Bajaj Finance Ltd.	12.56
Hindustan Petroleum Corporation Ltd.	10.42
Eicher Motors Ltd.	9.41
Interglobe Aviation Ltd.	9.37
HDFC Bank Ltd.	6.66
Ajanta Pharma	6.57
Lupin Ltd.	6.19
Housing Development Finance Corporation Ltd.	5.30

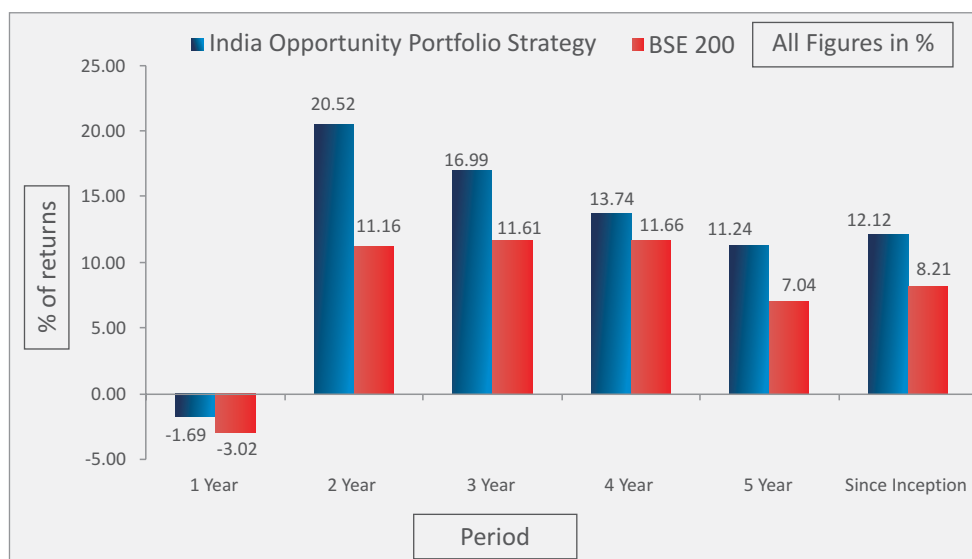
Data as on 30th April 2016

*Above 5%

Key Portfolio Analysis

Performance Data	IOPS	BSE 200
Standard Deviation (%)	15.07	16.23
Beta	0.79	1.00

Data as on 30th April 2016



Data as on 30th April 2016

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Focused Series V - A Contra Strategy

Strategy Objective

The strategy aims to invest in fundamentally sound companies that can benefit from changes in a company's valuation which reflects a significant change in the markets view of the company over a horizon of three years. The Strategy focuses on investing in stocks that can benefit from growth in earnings, re-rating of business or higher valuation of assets. Objective is to increase return rather than reduce risk for Investors.

Investment Strategy

- Buy and hold philosophy – low portfolio churn
- Follows the principle to pick best rather than diversification
- Concentrated Strategy Structure of less than 10 stocks
- Investment Horizon : Medium to Long term

Details

Fund Manager : Manish Sonthalia
Date of Inception : 27th Sept. 2010
Benchmark : BSE 200
Investment Horizon : 2 to 3 Years
Subscription : Daily
Redemption : Daily
Valuation Point : Daily

Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	28.52
Oil and Gas	27.56
Auto & Auto Ancillaries	22.62
Engineering & Electricals	9.16
FMCG	7.91
Cash	1.33

Data as on 30th April 2016

*Above 5% & Cash

Top Holdings

Particulars	% Allocation*
Bharat Petroleum Corpn. Ltd	15.58
Kotak Mahindra Bank Ltd.	14.42
Bharat Forge Ltd.	12.70
Petronet LNG Limited	11.98
Eicher Motors Ltd.	9.93
Max Financial Services Ltd	8.60
ITC Ltd.	7.91
Triveni Turbine Limited	7.01
J&k Bank	5.49

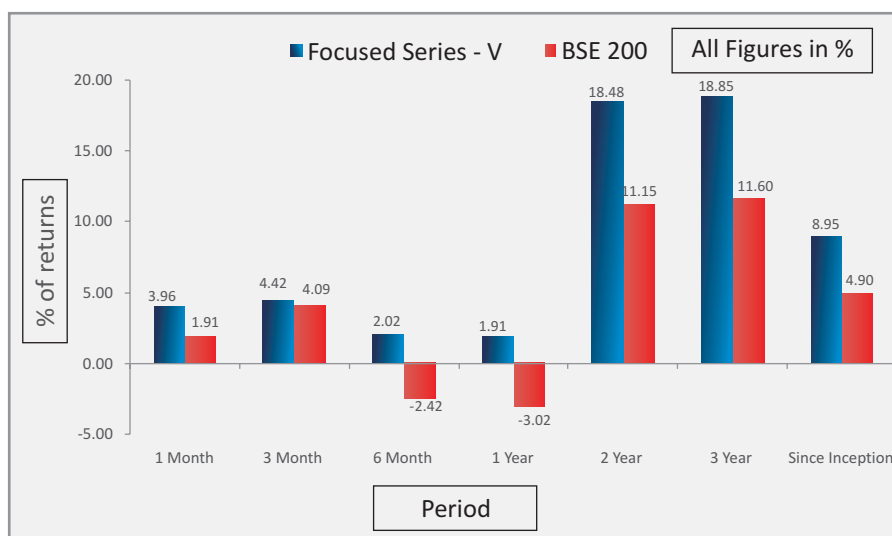
Data as on 30th April 2016

*Above 5%

Key Portfolio Analysis

Performance Data	Focused Series - V	BSE 200
Standard Deviation (%)	36.64	16.28
Beta	1.06	1.00

Data as on 30th April 2016



Data as on 30th April 2016

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