

# MONTHLY Communique

October 2018



**Aashish P Somaiyaa**  
(CEO)

Dear Investors and my dear advisor friends,

The last few weeks have been truly violent in the stock markets. Just the month of September alone saw the small cap index Nifty SmallCap 100 decline by over 19%, Nifty MidCap 100 by 13% and the Nifty itself by about 7%. For the first 9 months of the calendar year we are now down 32% and 17.6% respectively on the small and midcap indices while the Nifty is still up about 5.6% in this calendar year – albeit the Nifty is also giving up its gains real fast at the time of writing this note.

This year has seen a series of events that have caused the markets to take this rather pessimistic turn, now coming across like a panic situation. Some of the occurrences are enlisted below:

- a) Introduction of LTCG resulting in some rush for booking profits.
- b) Additional Surveillance Mechanism introduced by stock exchanges which basically put significant number of small cap stocks into 5% price movement bands – reducing liquidity and sparking a sell-off in such stocks.
- c) Deterioration in macroeconomic conditions like rise in crude prices, significant appreciation in USD resulting in relative depreciation across emerging market conditions and a 15%+ decline in the rupee to dollar exchange rate.
- d) Defaults on borrowings by IL&FS resulting in fear of credit quality across NBFCs and a spike in required yield for lending to NBFCs; this may impact their ability to refinance debt and also curtail their net interest margins in the near future.

Coming on the back of a year like CY2017 where Nifty, Nifty MidCap and SmallCap indices rose 28.5%, 48.5% and 57% respectively, any number of reasons for the decline in 2018 would not seem out of ordinary. After a significant rise, markets do tend to mean revert and the pointers written above may just be facilitators for an imminent correction probably anyway waiting to happen, which we are now seeing in hindsight. Hence the key is not to get overly focused or carried away about just the specific negative developments but also gather one's thoughts and be clear that irrespective of the reasons, the markets are basically mean reverting in nature and after such a sharp rise in the previous year, it is probably not out of place for markets to correct a bit this year. None of this is going to take the markets away from their long term trajectory. As Nick Murray writes in his famous book, *The Excellent Investment Advisor; Downs are Temporary, Ups are Permanent*”.

At the time of writing this note, the market seems to be in the grip of fear and there is an indiscriminate decline in the values of stocks starting first with mid and small caps and then spreading into quality large cap companies. There seems to be no appreciation of good or bad and everything seems to be painted in the same stroke, at least if price movement was to be taken as an indicator of goodness of an investment. The fact that market is not able to distinguish between what is impacted by the above developments on a lasting basis and what is not impacted; it proves that there is widespread fear and panic.

(Continued overleaf)

**THINK EQUITY**  
**THINK MOTILAL OSWAL**

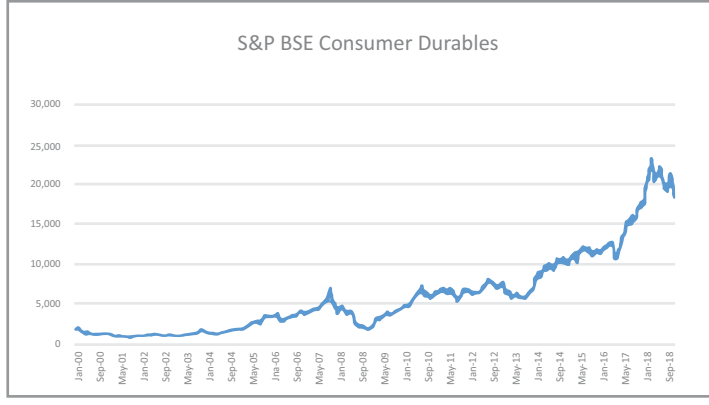
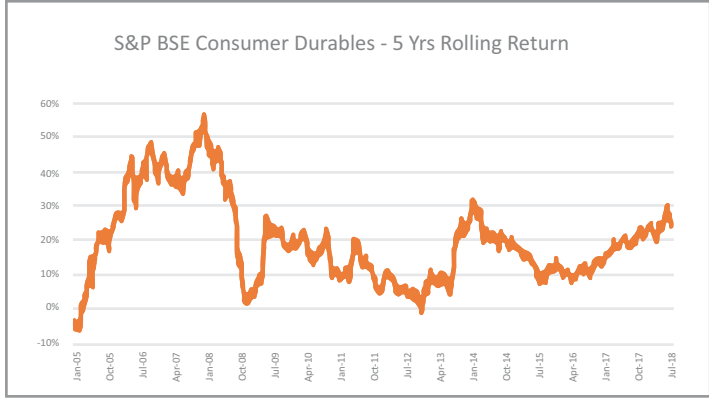
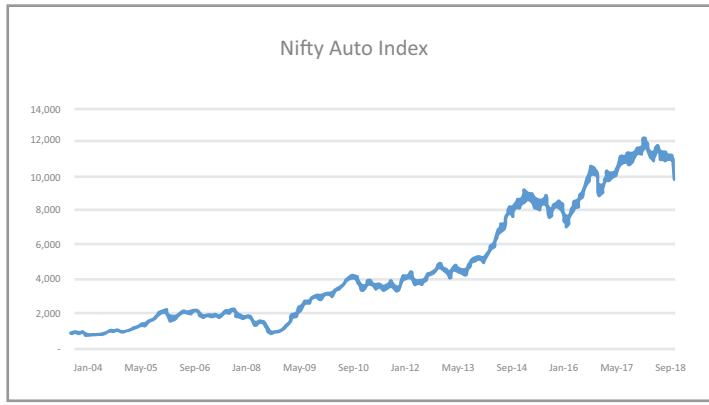
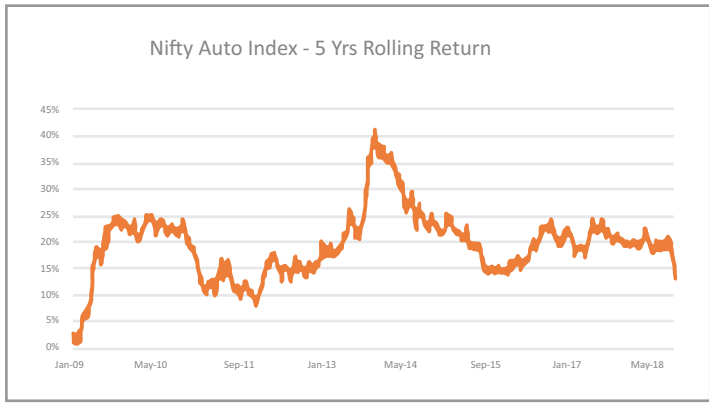
**MOTILAL OSWAL**  
Asset Management  
**PORTFOLIO STRATEGY**

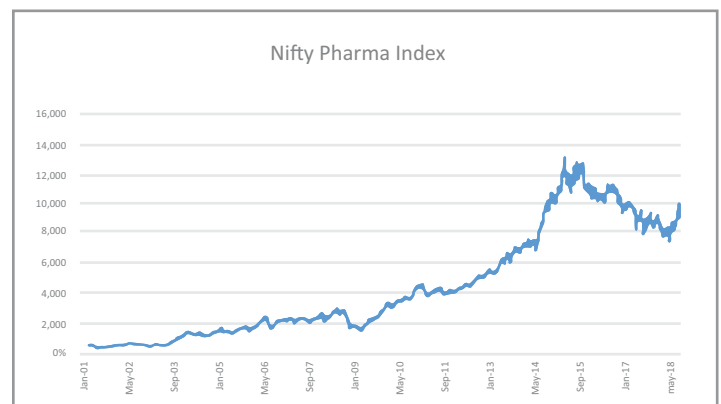
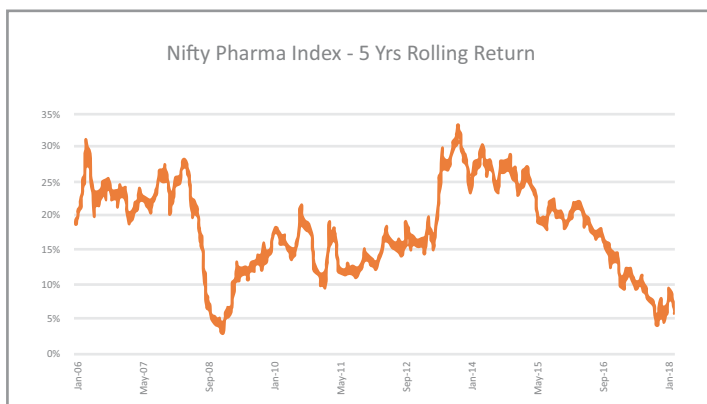
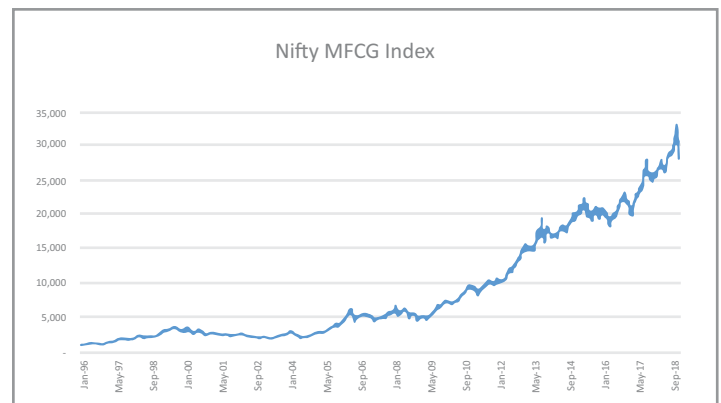
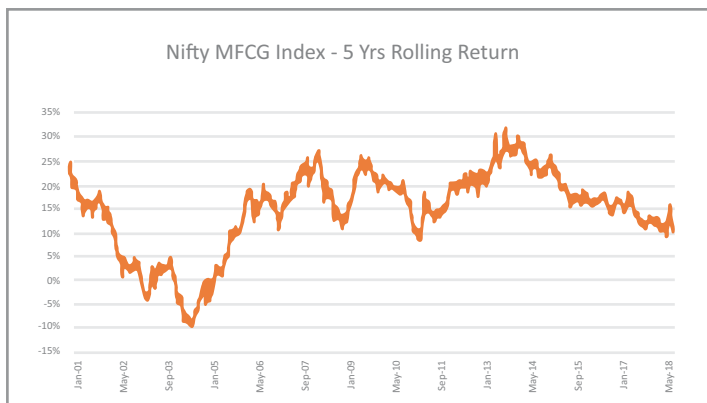
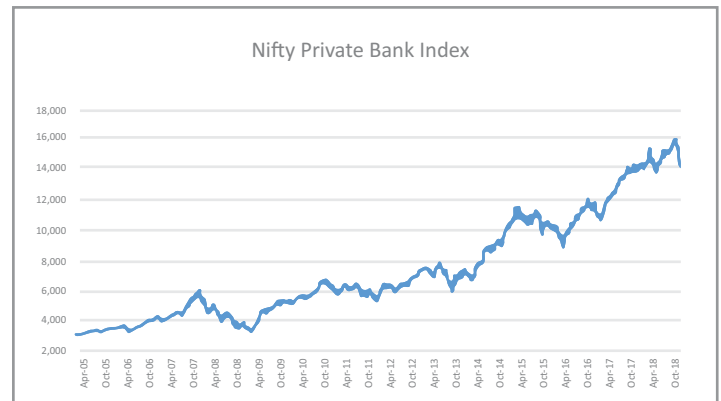
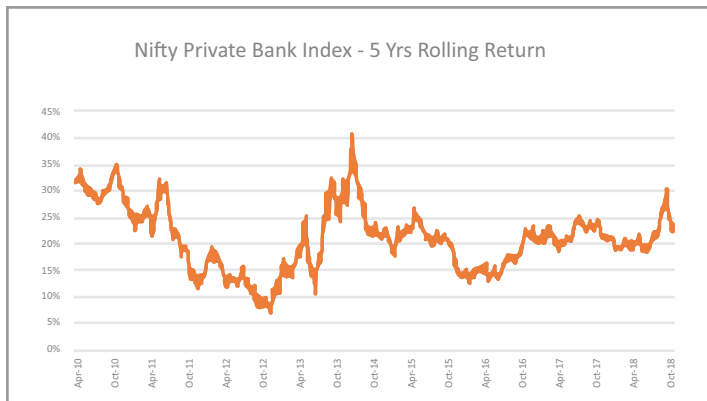
**BUY RIGHT**  
**SIT TIGHT**



Across Motilal Oswal Equity Funds, we do not have any undue exposures to sectors that get heavily impacted by the steep currency decline or credit related issues at NBFCs. While all NBFCs do get impacted with rise in interest rates our key exposures are restricted to high quality franchise like HDFC and Bajaj Finance. Barring these two companies we have negligible exposure to the entire NBFC sector. Similarly, our exposure to cyclicals or leveraged companies or interest rate sensitive stocks is practically zero. Our portfolios as always are overweight in secular themes such as private sector banks, insurance companies, consumer durables / discretionary and consumer staples, autos etc. A lot of these high quality companies have had a time correction over the last one year and in fact in the month of September and early October there has been significant capital correction in line with the broader markets. Marquee names like Eicher, Bajaj Finance, HDFC, HDFC Bank, HDFC Life, ICICI Lombard, Kotak Bank etc. have seen 30-35% decline in values in a span of few weeks. Private sector banks and insurance companies in some ways stand to gain out the current market turmoil with NBFC and capital market entities but as I said before, market behaviour is indiscriminate at the current juncture and we must take benefit of the market's inability to differentiate the good from bad. Without commenting on the broader markets, keeping only our quality and growth oriented investment style in mind, we believe that there is value emerging and this situation augurs very well for future returns from hereon. As is the cliché, it is about time to get greedy about buying good companies at great discounts and we need your support to be able to act on opportunities. Whenever the dust settles these will be the names that will find takers first.

With an economy like India and its current stage of development we believe that secular themes like private sector banks, autos, consumer durables / discretionary and consumer staples, IT and Pharma have rewarded patient investors in the past and is expected to continue to do so for some time to come. In the current markets there is some disenchantment with the broader financial services sector but within financial services our portfolios are tilted mainly in favour of private sector banks, quality NBFCs and insurance companies rather than the broader financial services sector. Past data presented below in the form of charts clearly shows that some of these sectors even after the sharp fall off late still have always delivered positive returns for any 5 year time frame of investment. While I am using broad indices below, we would be sticking our neck out and trying to get only the best ideas into our portfolios.





Source: NSE & internal analysis; Data as on 5th October 2018

The charts clearly show that share prices and markets can move from undervaluation to overvaluation but since these are reasonably secular sectors, ultimately in line with their consistent earnings trajectory they have always rewarded investors over any 5 year time frame and over the long term. At Motilal Oswal AMC, across portfolios anywhere between 60-90% of our portfolios are dedicated to quality companies in these sectors. We do get impacted by cycles of overvaluation and undervaluation and you may have noticed our efforts to book profits where needed but eventually these sectors held over a long period of time are bound to reward the patient investor. Also keep in mind that there are enough and more companies in the markets which if bought at the wrong time can result in severe capital erosion. But companies from the sectors listed above, even if on hindsight one realises they are bought at a high price, the worst outcome is a time correction and maybe some elongation of holding periods for one to get rewarded, but a capital loss over a period of 3-5 years is most unlikely as is evident from the charts.

One of the areas that are causing massive discomfort to many investors is the fall in small and midcap segments of the market. In our experience the upper end of smallcap and the midcap range is where wealth is created in any five year time frame and there is hard data backing this learning; presented below. While the volatility can surely give one sleepless nights it is part and parcel of the wealth creation process.



If we were to divide the market into 3 baskets by their market cap ranks and then check the performance of each of these 3 baskets we would get to prove the above belief. So we divide the market into three strata - top 100 companies by market cap, next 200 and then 301 and beyond that's the rest. Let's call the top basket megacap, the middle one has midcap and the rest as minicap. The below data shows how companies in each of these strata by market capitalization have fared in any 5 year time bucket of investment. For instance, if one sees the data for 2010-2015 it says that for the basket of companies from rank 301 and beyond by market cap (minicaps), the probability that a minicap company would go onto becoming megacap in 5 years is virtually ZERO (3 companies out of 1908) but the probability that a minicap company would go onto becoming a midcap is 3.5% (64 out of 1908) and the average return of such companies is 38% CAGR. Clearly the probability of success in this segment looks low even though potential returns may look high. On the other hand the probability that a midcap company in the favoured market cap range would go onto becoming a megacap company in 5 years is 12% (24 out of 200) and the average return of such companies is 33% CAGR. A full 88 out of 200 companies (44%) remained in the midcap basket with an average CAGR of 9% which means many companies had a good double digit CAGR and even if companies remain in this range they can produce respectable returns; remember the band ranges from around 7,500 crs to about 30,000 crs. The learning from the data is that significant wealth creation is achieved by remaining invested in the relevant market cap baskets where fund managers have done quality stock picking with a long term perspective. I urge you to evaluate each chart using the methodology of reading described above. You will notice that irrespective of market scenario and the years in question, broadly the findings are the same.

PLEASE NOTE THAT THE BASKETS DEFINED HERE ARE NOT WHAT IS TYPICALLY REFERRED TO AS SMALL MID OR LARGE CAP. STOCK NO 101 TO 300 BY MARKET CAP WOULD BE APPROXIMATELY THE RANGE FROM RS 7,500 CRS TO 30,000 BY MARKET CAP. THIS IS THE PREDOMINANT RANGE WHERE WE MANAGE IOP. WE DO NOT HAVE ANY PMS THAT ARE MUCH BELOW THIS RANGE OF MARKET CAP AND THAT IS A DELIBERATE POSITIONING.

**Mini, Mid, Mega crossovers - 2000-05, 2005-10, 2010-15**      Note: Figures In brackets indicate number of companies

Period	Market return	Mega	To Mid	Mini
2000-05: Median return CAGR	5%	158% (1)	57% (58)	19% (1,039)
2005-10: Median return CAGR	22%	76% (2)	61% (25)	11% (1,465)
2010-15: Median return CAGR	10%	68% (3)	38% (64)	0% (1,841)

Period	Market return	Mega	To Mid	Mini
2000-05: Median return CAGR	5%	55% (17)	21% (90)	-3% (93)
2005-10: Median return CAGR	22%	46% (9)	24% (89)	4% (102)
2010-15: Median return CAGR	10%	33% (24)	9% (88)	-19% (88)

Period	Market return	Mega	To Mid	Mini
2000-05: Median return CAGR	5%	21% (59)	-4% (28)	-40% (13)
2005-10: Median return CAGR	22%	27% (66)	9% (32)	-32% (3)
2010-15: Median return CAGR	10%	11% (71)	-13% (26)	-32% (3)

Total stocks: 2000-05 (1,098, 200, 100); 2005-10 (1,492, 200, 100); 2010-15 (1,908, 200, 100)

**2013-18: Median return CAGR**  
Market return: 12%

Mega	80% (1)	43% (16)	15% (71)
To Mid	61% (46)	23% (90)	0% (26)
Mini	18% (2,462)	-3% (83)	-20% (3)

Total stocks: 2,509, 197\*, 100  
\* 3 Companies from Mid segment got delisted or merged

An overlap of the above market cap segments and the right sectors to chose from can be a winning combination for any index / broad market agnostic long term fundamental investor. We have similar success stories to share from the build up of our Next Trillion Dollar PMS strategy in 2008-09-10 when there was a similar decline in small and midcap values but holding onto the right ideas without reacting resulted in significant wealth creation.

**2008-13: Median return CAGR**  
Market return: 5%

Mega	<b>0%</b>	<b>28%</b>	<b>5%</b>
	(0)	(26)	(74)
To Mid	<b>23%</b>	1%	-18%
	(84)	(93)	(23)
Mini	-7%	-30%	-37%
	(2,225)	(80)	(3)
	<b>Mini</b>	<b>Mid</b>	<b>Mega</b>
	<b>From</b>		
Total stocks	2,309	199**	100

\*\*1 Midcap company IGATE Computer was delisted/merged which was part of 2008 universe.

**2009-14: Median return CAGR**  
Market return: 20%

Mega	<b>94%</b>	<b>47%</b>	<b>21%</b>
	(1)	(18)	(75)
To Mid	<b>66%</b>	23%	-3%
	(52)	(95)	(20)
Mini	8%	-10%	-28%
	(2,305)	(85)	(5)
	<b>Mini</b>	<b>Mid</b>	<b>Mega</b>
	<b>From</b>		
Total stocks	2,358	198***	100

\*\*\*2 Midcap Companies IGATE Computer and Chettinad Cement Corporation was delisted/merged which was part of 2009 universe.

Source: Motilal Oswal Asset management internal analysis

In all our funds we remain committed to our QGLP philosophy and broadly the portfolio construct has not changed much other over last year. We expect the portfolios to deliver superior ROE and earnings growth and this coupled with the sharp price correction recently leads to attractive valuation. We also believe that the sector rotation issue in the market is transitory and high quality high growth companies will be rewarded sooner than later especially with the commencement of a new result season and market likely to become more discerning of quality after this hard knock. If good stocks representing marquee companies have fallen 40% and some of the junk has fallen 50-60%, once the dust settles it's the quality that will find takers.

# Value Strategy

## Investment 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. Value is a large cap oriented strategy where investments are made with long term perspective with industry leaders.

## Details

Fund Manager : Shrey Loonker  
 Strategy Type : Open ended  
 Date of Inception : 24th March 2003  
 Benchmark : Nifty 50 Index  
 Investment Horizon : 3 Years +

## Market Capitalization

Market Capitalization	% Equity
Large cap	94
Mid cap	4
Small cap	1

## Top 10 Holdings

Particulars	% Allocation
HDFC Bank Ltd.	11.61
Kotak Mahindra Bank Ltd.	9.12
Bharat Petroleum Corporation. Ltd	6.81
Bajaj Finserv Ltd.	6.80
Sun Pharmaceuticals Ltd.	6.59
AU Small Finance Bank Ltd.	6.15
ICICI Lombard General Insurance Company Ltd.	5.84
Larsen & Toubro Ltd.	5.71
Bharat Forge Ltd.	5.68
Eicher Motors Ltd.	5.63

Data as on 30<sup>th</sup> September 2018

## Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	49.42
Auto & Auto Ancillaries	21.01
Oil & Gas	10.06
Pharmaceuticals	7.66
Engineering & Electricals	5.71
Cash	1.42

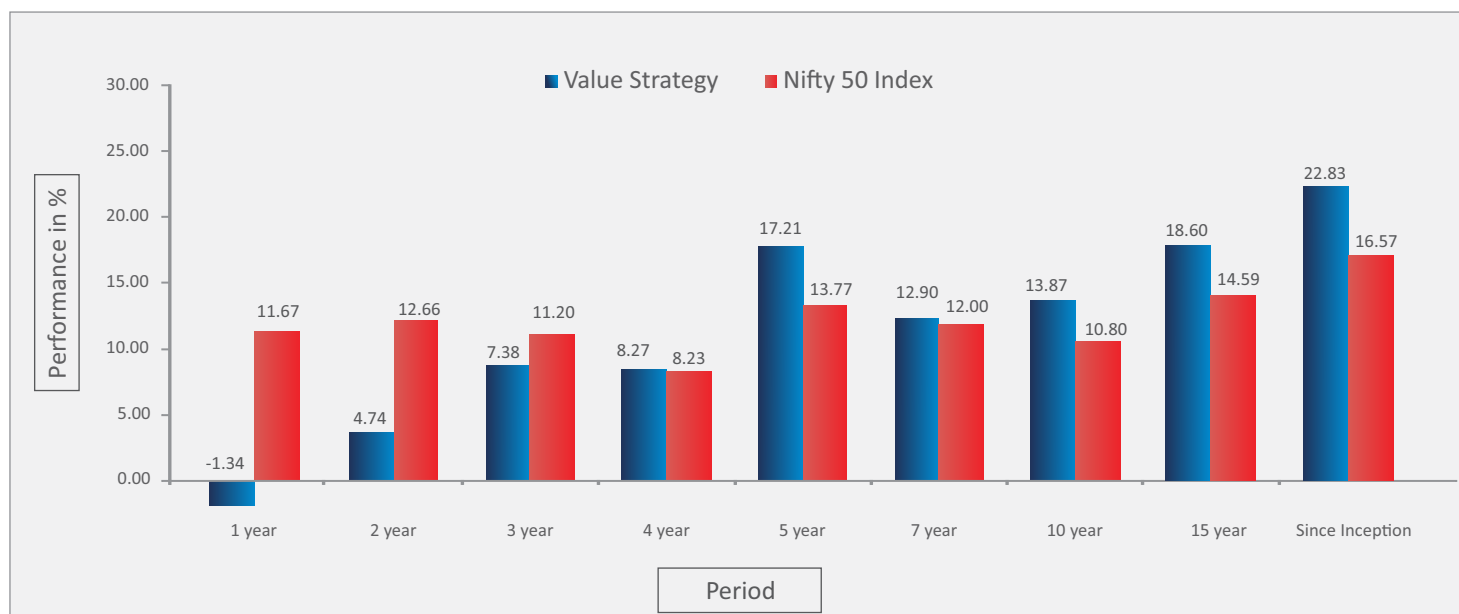
Data as on 30<sup>th</sup> September 2018

\*Above 5% & Cash

## Key Portfolio Analysis

Performance Data (Since Inception)	Value Strategy	Nifty 50
Standard Deviation (%)	20.49%	22.60%
Beta	0.82	1.00

Data as on 30<sup>th</sup> September 2018



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 30<sup>th</sup> September 2018. 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

## Investment 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. Focus is on businesses benefitting from growth in GDP.

\*The selection of the stocks will be based on the criteria of strategy at the time of initial ideation and investment made as per the model portfolio of the strategy

## Details

Fund Manager : Manish Sonthalia  
 Strategy Type : Open ended  
 Date of Inception : 11th December 2007  
 Benchmark : Nifty 500  
 Investment Horizon : 3 Years +

## Market Capitalization

Market Capitalization	% Equity
Large cap	39
Mid cap	53
Small cap	5

## Top 10 Holdings

Particulars	% Allocation
Page Industries Ltd.	12.28
Kotak Mahindra Bank Ltd.	11.17
Voltas Ltd.	8.49
Bajaj Finance Ltd.	6.96
Eicher Motors Ltd.	5.42
City Union Bank Ltd.	5.07
L&T Technology Services Ltd.	4.88
Bosch Ltd.	4.47
Godrej Industries Ltd.	3.64
Max Financial Services Ltd.	3.61

Data as on 30<sup>th</sup> September 2018

## Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	29.32
FMCG	20.12
Auto & Auto Ancillaries	13.24
Diversified	12.13
Cash	3.39

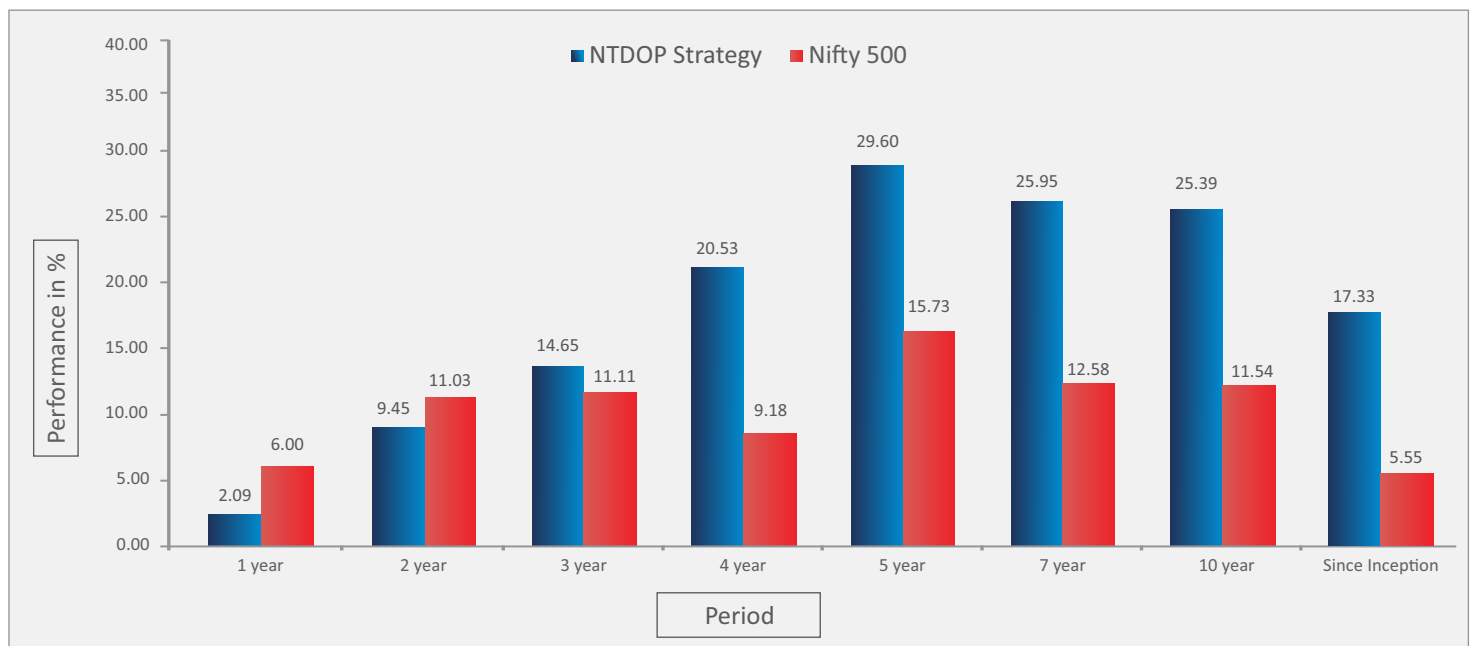
Data as on 30<sup>th</sup> September 2018

\*Above 5% & Cash

## Key Portfolio Analysis

Performance Data (Since Inception)	NTDOP	Nifty 500
Standard Deviation (%)	17.78%	21.37%
Beta	0.69	1.00

Data as on 30<sup>th</sup> September 2018



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# India Opportunity Portfolio Strategy

## Investment 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. The strategy is for investors who are keen to generate wealth by participating in India's growth story over a period of time.

## Details

Fund Manager	: Mr. Manish Sonthalia
Associate Fund Manager	: Mr. Atul Mehra
Strategy Type	: Open ended
Date of Inception	: 11th Feb. 2010
Benchmark	: Nifty Smallcap 100
Investment Horizon	: 3 Years +

## Market Capitalization

Market Capitalization	% Equity
Large cap	–
Mid cap	26
Small cap	74

## Top 10 Holdings

Particulars	% Allocation
Development Credit Bank Ltd.	8.79
AU Small Finance Bank Ltd.	7.96
Birla Corporation Ltd.	7.75
Aegis Logistics Ltd.	6.97
TTK Prestige Ltd.	6.24
Alkem Laboratories Ltd.	6.04
Qess Corp Ltd.	5.71
Gabriel India Ltd.	5.69
Mahanagar Gas Ltd.	5.53
Dishman Carbogen Amcis Ltd.	4.54

Data as on 30<sup>th</sup> September 2018

## Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	26.09
Pharmaceuticals	15.03
Oil & Gas	12.50
Cement & Infrastructure	10.69
Consumer Durable	9.91
Services	5.71
Auto & Auto Ancillaries	5.69
Cash	0.11

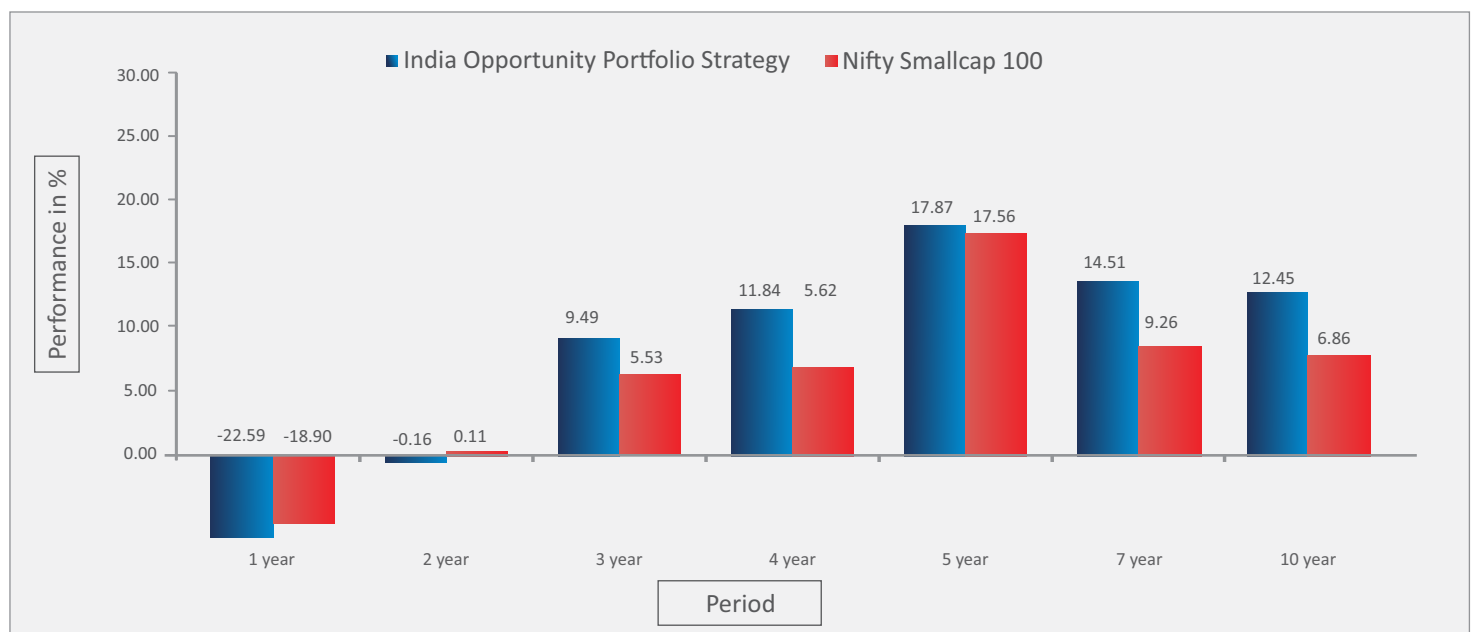
Data as on 30<sup>th</sup> September 2018

\*Above 5% & Cash

## Key Portfolio Analysis

Performance Data (Since Inception)	IOPS	Nifty Smallcap 100
Standard Deviation (%)	15.34%	19.70%
Beta	0.57	1.00

Data as on 30<sup>th</sup> September 2018



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 30<sup>th</sup> September 2018. 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.



# India Opportunity Portfolio V2 Strategy

## Investment Objective

The Strategy aims to deliver superior returns by investing in stocks from sectors that can benefit from India's emerging businesses. It aims to predominantly invest in Small and Midcap stocks\* with a focus on identifying potential winners. Focus on Sectors and Companies which promise a higher than average growth.

\*The selection of the stocks will be based on the criteria of strategy at the time of initial ideation and investment made as per the model portfolio of the strategy

## Details

Fund Manager	: Mr. Manish Sonthalia
Associate Fund Manager	: Mr. Atul Mehra
Strategy Type	: Open ended
Date of Inception	: 5th Feb. 2018
Benchmark	: Nifty Smallcap 100
Investment Horizon	: 3 Years +

## Market Capitalization

Market Capitalization	% Equity
Large cap	–
Mid cap	45
Small cap	54

## Top 10 Holdings

Particulars	% Allocation
Heg Ltd.	9.67
Gruh Finance Ltd.	8.42
Cholamandalam Investment And Finance Company Ltd.	7.17
Coffee Day Enterprises Ltd.	7.12
Godrej Agrovet Ltd.	6.91
Ipca Lab Ltd.	6.79
Bajaj Electricals Ltd.	6.41
Sundaram Fasteners Ltd.	5.33
JK Lakshmi Cement Ltd.	5.07
Sobha Ltd.	4.92

Data as on 30<sup>th</sup> September 2018

## Top Sectors

Sector Allocation	% Allocation*
Banking & Finance	23.23
Electricals & Electronics	19.22
Agriculture	10.79
Pharmaceuticals	8.06
Restaurants	7.12
Auto & Auto Ancillaries	5.33
Cement	5.07
Cash	0.77

Data as on 30<sup>th</sup> September 2018

\*Above 5% & Cash

## Key Portfolio Analysis

Performance Data (Since Inception)	IOP V2	Nifty Smallcap 100
Standard Deviation (%)	17.52%	20.52%
Beta	0.69	1.00

Data as on 30<sup>th</sup> September 2018

## Performance

Period	IOP V2	Nifty Smallcap 100
1 Months	-13.33	-19.79
3 Months	-10.39	-14.31
6 Months	-16.20	-21.06
Since Inception (5th Feb 2018)	-12.07	-26.01

Data as on 30<sup>th</sup> September 2018

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