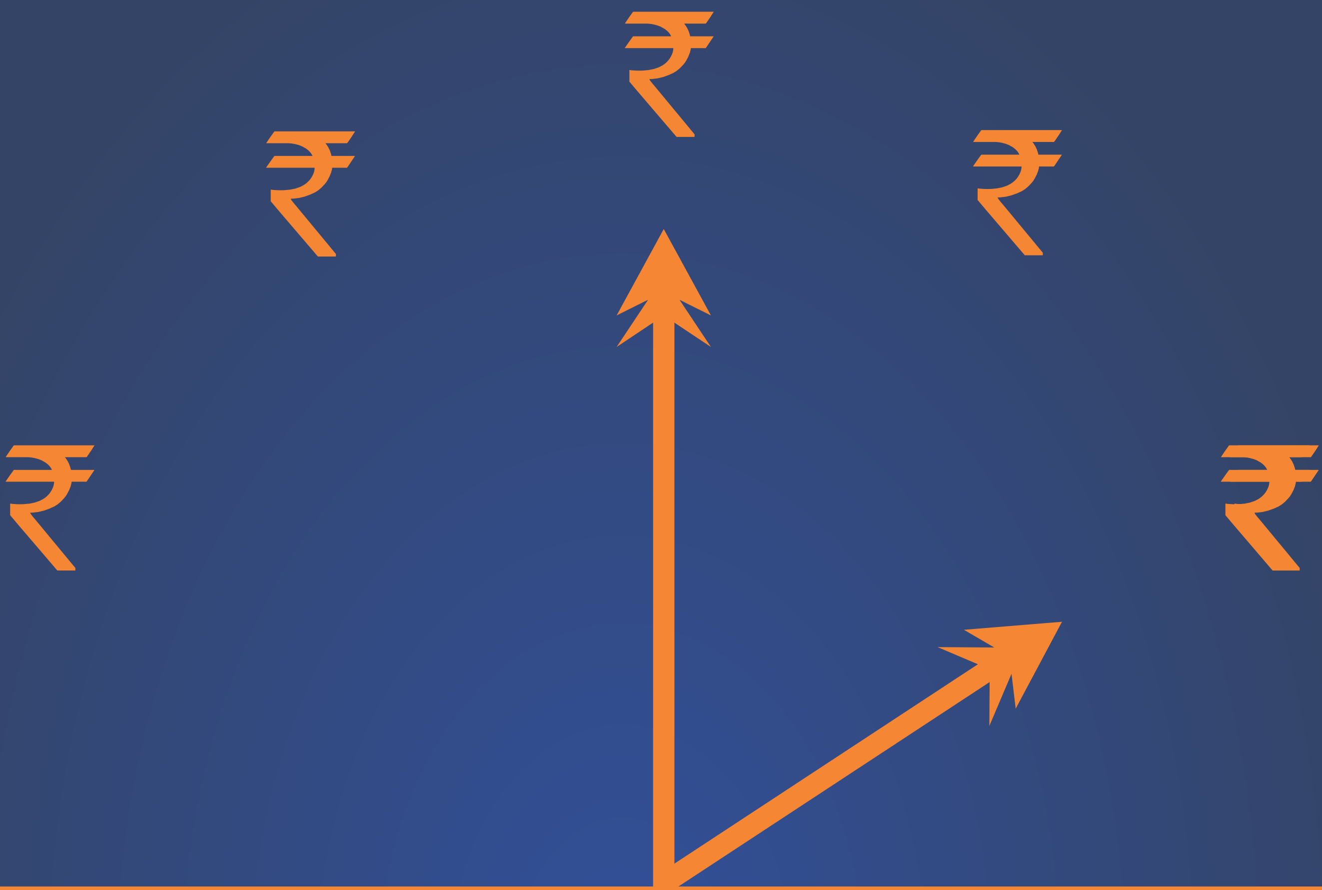


TIME & MONEY

"Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years"

- Warren Buffett

Motilal Oswal
Asset Management

BUY RIGHT
SIT TIGHT

It takes two to tango

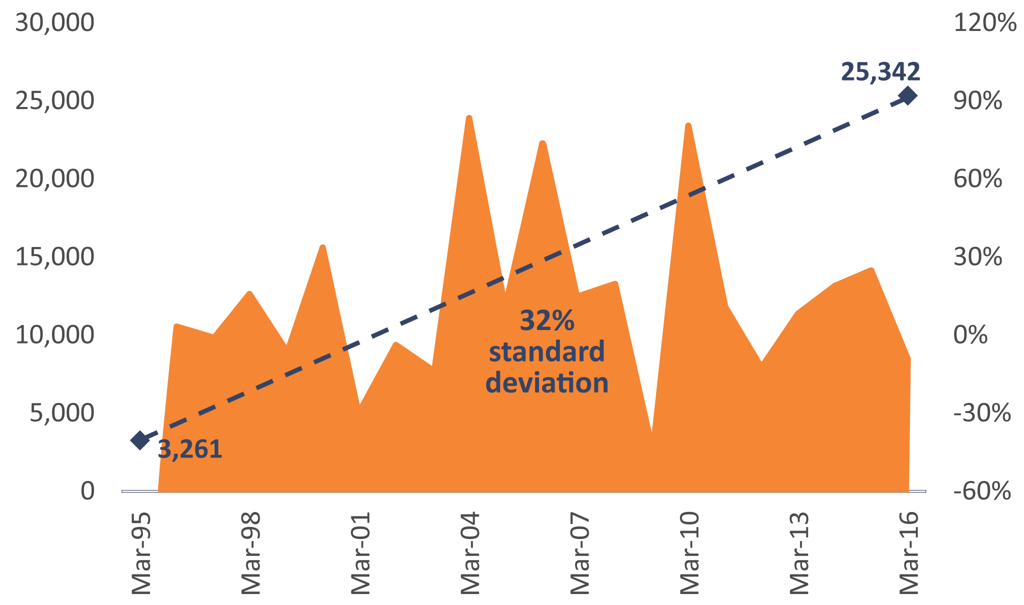
At Motilal Oswal AMC, we have a simple investing philosophy – 'Buy Right : Sit Tight'. We buy quality stocks based on our QGLP stock picking process. And hold on to them to achieve their growth potential. But this philosophy is not enough to make money, it needs the most important endorsement – *yours*. Because it's only when you sit tight on your investments they reach their full growth potential.

They say time is money. When it comes to your investments this is true, quite literally!

Sit tight on your investments untill they achieve their true potential

A. Sensex – High Standard deviation of 32% in annual returns

In the long term, share prices are slaves of the earnings.



Source: MOAMC Internal Analysis. Data as on March 31, 2016. Past performance may or may not be sustained in the future

Over the 21 year period from March '95 to March '16, the Sensex moved from 3,261 to 25,342. During this period, the Sensex compounded 10% CAGR but the standard deviation (Measure of volatility and hence risk) was 32%.

B. Sensex Vs Sensex EPS Growth

In the table check the upheaval of FY09 and FY10. As a result of the Global Financial Crisis, in FY09 the index fell 38%! But in that year the earnings decline was only 2%. In the next year, i.e. FY10 the index bounced back 81%, but earnings recovered only 2%! So in two financial years when index fell 38%, bounced back 81% and in general investors lost lot of money, the net change to corporate earnings was almost NIL - no change at all!!! What was all that hullabaloo about?

Also worth checking are the red circles, which clearly demonstrate that there can be leads or lags between the movements of share prices and earnings.

In FY09 and FY10 when index fell 38%, bounced back 81%

21-years CAGR of Sensex at 10% is exactly the same as 21-years Sensex EPS CAGR!

Year	Sensex	YoY	Sensex EPS	YoY
Mar-95	3261		181	
Mar-96	3367	3%	250	38%
Mar-97	3361	0%	266	6%
Mar-98	3893	16%	291	9%
Mar-99	3740	-4%	278	-4%
Mar-00	5001	34%	280	1%
Mar-01	3604	-28%	216	-23%
Mar-02	3469	-4%	236	9%
Mar-03	3049	-12%	272	15%
Mar-04	5591	83%	361	33%
Mar-05	6493	16%	446	24%
Mar-06	11280	74%	540	21%
Mar-07	13072	16%	720	33%
Mar-08	15644	20%	833	16%
Mar-09	9709	-38%	820	-2%
Mar-10	17528	81%	834	2%
Mar-11	19445	11%	1024	23%
Mar-12	17404	-10%	1120	9%
Mar-13	18836	8%	1180	5%
Mar-14	22386	19%	1329	13%
Mar-15	27957	25%	1354	2%
Mar-16	25341	-9%	1330	-2%
Std Dev		32%		14%
CAGR	10%		10%	

The table above is used to explain the concept and is for illustration purpose only. It should not be used for development or implementation of an investment strategy and should not be construed as an investment advice to any party. Past performance may or may not be sustained in future.
Data as on 31st March 2016, Data Source: Bloomberg

Learning from long range data

When we buy shares, we are indeed buying a share of earnings of companies. The word "share" in share market stands for "share of earnings"

Over long period of times, share prices deliver exactly in line with growth in earnings

However, data shows that volatility in share prices is over twice that of volatility in earnings

Share prices typically are expected to discount future; arithmetically they reflect current value of future cash flows

As a result of volatility which is caused by changes in expectations of earnings, there are times when share prices lead earnings and there are times when share prices lag earnings

In a nutshell, over long periods of time equities do deliver in line with corporate earnings; but it's a known fact that the volatility in share prices is way higher than volatility of earnings themselves. This volatility in share prices results in emotional response of greed in rising markets and fear in falling markets. Mostly these responses are way more exaggerated on upside as well as downside. When evaluated in hindsight after the data plays out; one usually rues that responses were disproportionate to changes in corporate earnings.

Volatility in share prices is way higher than volatility of earnings themselves

Why do people cash out?

Despite all the above understanding and best intentions; people redeem their investments even in quality portfolios. While sometimes the reasons could be a genuine need for money; for example, large expenses, emergency etc.; many a times investors are compelled to make erratic decisions due to passing emotions or advice from non-professionals such as friends and relatives or upheaval in any other part of the world, political catastrophe etc. which rarely affect the investors' asset who is miles away from the damage. Let's examine each of these reasons and see if you really should cash out.

5 Reasons why people redeem

1. Redeem to book profits

Timing the Market vs. Time in the Market

Many times people have invested wisely and within couple of years; they think they have made enough to cash out because returns are more than the fixed interest or higher than expected. They book profits happily, feeling that they have timed the market- in and out. One must note that if you get 20% returns for 2 years and then 7%-8% returns for next 2 years, the average CAGR is approximately 13% for the consolidated period of 4 years.

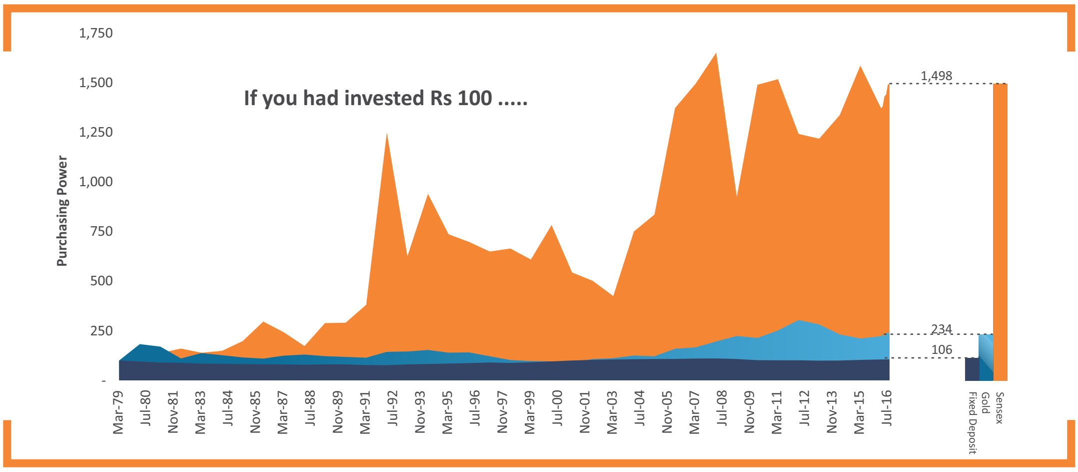
As one can surmise from this information, the happiness of booking profits can turn to regret. If you want to make serious money or create wealth; the longer you hold the greater your chances of multiplying as you would not only ride the whole growth cycle, you would also benefit from the power of compounding. Some of our experiences are listed below which illustrates the power of holding on to great businesses through the entire growth cycle.

The happiness of booking profits can turn to regret

Stock	Purchase Date	Adjusted Purchase Price	Current Market Price Aug 31, 2016	% Growth
Bosch Limited	Jun-03	497.00	24,167.80	4763
Hero MotoCorp Ltd	Jun-03	253.65	3,541.35	1296
Eicher Motors Ltd.	Apr-12	2054.80	22,750.95	1007
State Bank Of India	Jun-03	36.00	252.50	601
Hdfc Bank	Jul-08	201.00	1,291.20	542
HDFC Ltd	Jan-06	241.80	1,405.45	481

Source: MOAMC Internal Analysis
The Stocks mentioned are used to explain the concept and is for illustration purpose only and should not be used for development or implementation of an investment strategy. It should not be construed as investment advice to any party. The stocks may or may not be part of our portfolio/strategy/ schemes. Past performance may or may not be sustained in future

A. Further, the chart below is a proof that equity has outperformed other investment avenues in the long run.



Source: Bloomberg, MOAMC Internal Analysis, Data as on July 31, 2016. Past performance may or may not be sustained in future. Returns are inflation adjusted.

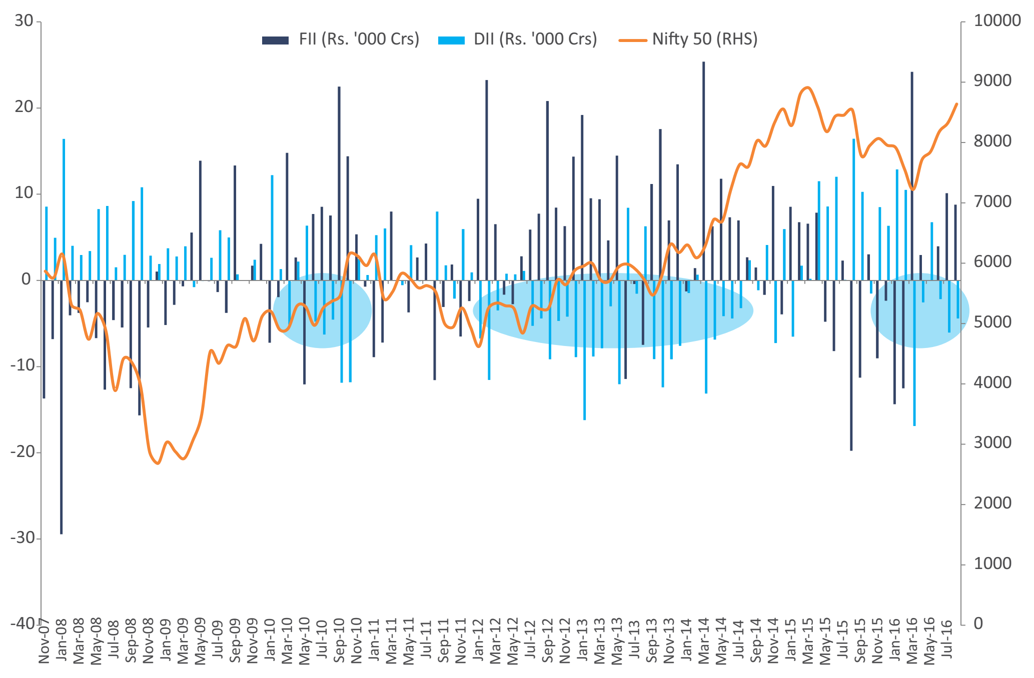
₹ 100 invested in SENSEX in March '79 has now grown to ₹ 1,490 while FD & Gold have grown only to ₹ 106 & ₹ 241 respectively

B. DII flows V/s FII flows

The other issue related to timing the market is our pre-occupation with macro events and global views, Foreign Institutional Investors (FII) flows etc. It is interesting to note that since the last peak of bull run in the market (December 2007 – January 2008) FII flow into equity markets is +209,000 crs and Domestic Institutional Investors (DIIs) flow is a mere +22,000 crs (see chart below). While we are so pre-occupied with tracking FII flows we seem to have missed the fact that they invested 10 times as much as we did in this period and supposedly the financial crisis originated in their domiciles not ours! The other alarming fact of this data is that whenever markets have been at lower levels and not trending in any directions, we have got frustrated and tired, thrown our hat and sold out (see the blue shaded circles below with DII flows showing huge negatives – they are the phases when Nifty 50 represented by the green line is range bound or going nowhere meaning not producing any returns for some measure of time).

This pre-occupation with seeking a positive trend the moment we invest is costing us dearly. On the other hand FII flows signified by red bars are more consistently positive than the blue bars which represent DIIs. Also worth noting that FII flow has only been negative when there are global concerns and seeing their behavior we have also sold. FIIs have generally not sold for local Indian reasons, their investment pattern is pretty much secular except for some time periods with global concerns, on the other hand we domestic investors have shown a largely "blow hot – blow cold" schizophrenic tendency of investing in fits and starts – there is no consistency in the blue bars! Sometimes hugely positive and then immediate long periods of pulling out. Not done! We ought to show more confidence in our markets than what foreigners have shown and irony of ironies we are spending time tracking when they are selling! Data shows they aren't selling, it's we who are selling!

Since the last peak of bull run in the market FII flow into equity markets is +209,000 crs and DIIs flow is a mere +22,000 crs



It's worth noting that FII flow has only been negative when there are global concerns and seeing their behavior we have also sold

Source: http://rbi.org.in/

The above graph is used to explain the concept and is for illustration purpose only and should not be used for development or implementation of an investment strategy. Past performance may or may not be sustained in future.

2. Redeem to cut losses

Removing Risk = Removing Returns

Sometimes if you have entered the market at an inopportune time even if your portfolio contains good quality stocks initially your portfolio returns may take a dip. Before writing the cheque we all tend to have a long term view but more often than not there seems to be an unstated condition that after I invest the values must start going up! Returns in variable return products are always average over a period of time, sometimes returns come front ended sometimes they may come back ended. Be that as it may, if the investment sees a decline immediately after investing; as soon as one sees recovery in capital value there is tendency to take the capital and scoot i.e. to cut losses at break even and cash out.

Now let's imagine that you have just entered the elevator to travel up to the 40th floor of a sky-scraper. All of a sudden there is a power outage, the elevator stops, there are no lights and fans. The generator doesn't immediately fire up so for about a minute or two you are left in complete darkness and you are starting to get suffocated. You are just about starting to panic, when suddenly the emergency response in the elevator kicks in, it moves to the closest floor and doors open.

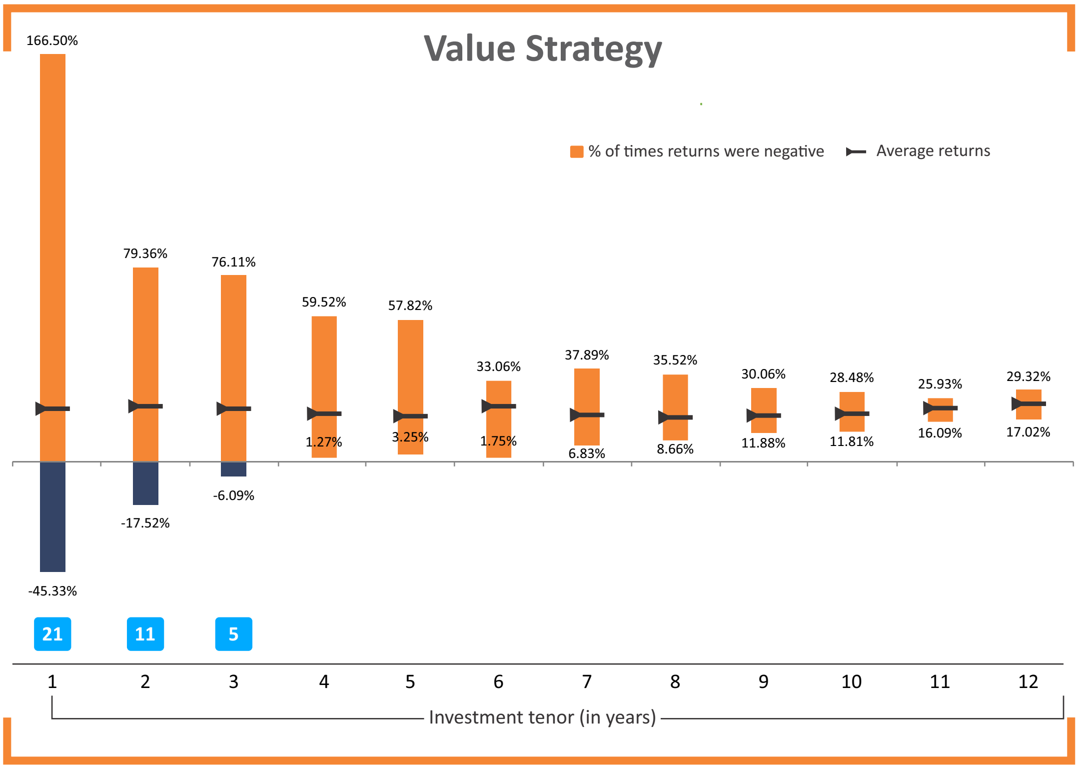
At this juncture, how many of us will stay in there thinking, ok, all good, I am going to stay here and go on for my meeting to the 40th floor? How many of us will rush out of the door thanking God for dear life! We all invest for our portfolios to appreciate but when we see a significant downward trend; its an elevator phenomenon that plays out. The moment the values are restored we forget about the appreciation and we are more than happy to walk out with the original sum. This may be good for riding up an elevator in the skyscraper, but it is disastrous when investing in equities. Investment in variable return products often witness a law of averages. Having seen the worst, we tend to exit before the best plays out.

But isn't that like clipping a birds wings just when it's about to take flight?

If you look at our Value PMS over the past 13+ years, on an average of 300+ observations a year; you will notice that while over 1-2 years minimum returns could result in a loss; if you hold for 3+ years , there are no observation points when you make a loss and maximum CAGR returns range from 59%+ to 25%+. Holding on to quality portfolios for time is one way of not only taking out the risk of equity investing, it is also a way to get good returns. Is holding on for at least 3+ years too much to ask for this? Can we align our goals?

When you hold high quality - high growth stocks, the worst outcome for buying at an inappropriate time is to have a time correction. It is our mandate to target a doubling of portfolio earnings in 3-4 years; and markets can only prepone or postpone the returns depending on sentiments and macro conditions.

Minimum to maximum returns for a respective time period (in %)



Total Number of time period ; One Year : 4472, Two year : 4107, Three year : 3742, Four Year : 3377, Five Year : 3011

It is our mandate to target a doubling of portfolio earnings in 3-4 years

Source: MOAMC Research, Data as on 31st Jul, 2016. Past performance may or may not be sustained in future. Returns are inflation adjusted.

3. Redeem to migrate to other asset classes

Planning Play & Playing Plan

Many time money moves from one asset class to another depending on the flavor of the month. This is where discipline in asset allocation comes in. Your money should ideally be allocated to various asset classes based on a strategy and you should stick to your plan. Moreover, if you look at the test of time; equity has outperformed other asset classes. What's more, investing in equity is the only way you can own a part of a large, well run business and participate in the benefits of its growth. So stick to your plan, stay invested...and reap the fruits of long term wealth creation

If you had invested in the Value Strategy in bad or good time and held on even for 3 years, here's what your would have made on an annualized basis. The worst loss you would have made is -3% while the positive side is a whopping 81% annual returns. If you "Buy Right : Sit Tight", the downside is limited while the upside is high

If you look at the test of time; equity has performed other asset classes

Portfolio performance vs product performance

As you will appreciate for any given product or strategy that you may have invested in, there will be periods of stellar performance and periods of not so great performance. Ideally one spreads investments as per an asset allocation plan and hence wealth would be held across a mix of bank deposits, gold, real estate, direct equities, mutual funds, bonds, savings balances etc. It is very important to see performance of any single product or component of the portfolio in light of the objectives and total performance of the overall wealth portfolio that one possesses. It is structurally impossible that at a given point all components of a portfolio can do well. Ideally investors must evaluate individual products in context of the space that they operate it. It is not advisable to fret over performance of every individual component or to have a desire that all components will deliver to potential at all times. Also, its not logical to compare an investment in fixed income instruments with an investment in gold along with investments into equities etc. It's obvious that one knows enough not to be making such direct comparison between these different asset classes but deeper thinking will reveal that more often than not the source of dissatisfaction with one tends to be the relative performance of another asset. How many times does one think, I should have put more money in there; that's doing so much better!

There will be periods of stellar performance and periods of not so great performance

As on	3 - year rolling return
Mar 06	81
Mar 07	32
Mar 08	31
Mar 09	-3
Mar 10	18
Mar 11	13
Mar 12	28
Mar 13	5
Mar 14	7
Mar 15	25
Mar 16	20

Returns for more than one year are compounded annualized. Past performance may or may not be sustained in the future.

If you "Buy Right : Sit Tight", the downside is limited while the upside is high

4. Redeem due to over expectations

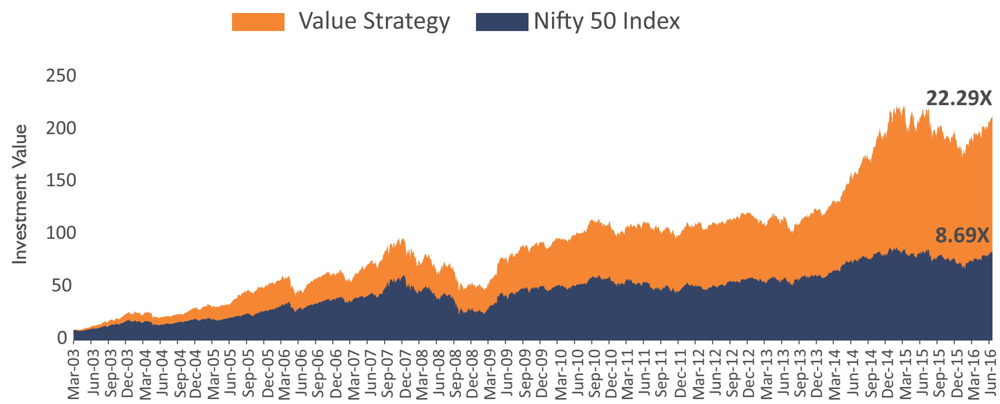
Improbable Performance Vs Possible Performance

Sometimes you look at the dazzling past performance of some best performing funds and invest in them assuming you will get similar returns. And if the returns these funds give are even slightly lower than their best previous performance, you are tempted to redeem as expectations are not matched. As a trend the top performing fund in any category changes every 18 months on an average. When investing in equity markets, one doesn't control the outcomes. Equity investing by nature is about probabilistic outcomes. It's only logical that when dealing with probabilistic outcomes which means when one can't control the outcomes, what one must control is the consistency and quality of inputs. There is nothing called consistency of performance, there is eventually only consistency of approach, discipline and philosophy - the discipline of buying companies that are profitable and whose profits are rising at steady clip.

The top performing fund in any category changes every 18 months on an average

Value Strategy is a classic example of consistent outperformance since its inception on 25th March, 2003. The chart given below, illustrates that Value Strategy has been continuously outperforming the benchmark, Nifty 50 Index since inception. As on 31st August, 2016, Value Strategy has delivered a CAGR of 25.97% as against 17.46% by Nifty 50 Index, an outperformance of 8.51% (CAGR).

Considering such a long and rich history of performance delivery, one must also note that there are times when performance is accentuated and there are times when performance is muted, what one will eventually get over a 3-5 year period is a decent average of both kind of phases. One can not expect that exactly after the point in time when one enters, the rosy phase starts!



The Above strategy returns are of a Model Client as on 31-Aug-2016. Returns of individual clients may differ depending on time of entry in the strategy. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. Strategy returns shown above are post fees & expenses. Returns above 1 year are annualized.

5. Redeem for variety

Switching Vs Sticking

Variety maybe the spice of life, but when it comes to investing, its consistency! World famous investors like Warren Buffett have made billions not looking for the next new/big investing story; but by investing in quality businesses and staying invested in them during their growth. There are solid investing ideas which are seen as fads and vice versa. The trick lies in being able to differentiate between the two. So look at the investing philosophy of the fund you have invested in rather than what sector/stock/ story is the flavor of the month. If you think the investing philosophy is sound, you should stay invested. Switching for variety may bring short term excitement but it's sticking to a sound investing philosophy that helps create wealth

So the next time you think of redeeming your money;
ask yourself sirf ek sawaal....
Kya portfolio mein rakha Time ka khayaal?

Should you have any queries, please write to aashishps@motilaloswal.com or MOAMC.Customercare@motilaloswal.com.
You could also call us on 1800-200-6626 (Toll Free) or visit motilaloswalmf.com