



The Covid-19 pandemic – market crash, and our response

Dear Investor,

As we write this newsletter on Tuesday March 31st, we have witnessed one of the worst falls in the stock market over the past month. The Large-cap Nifty 50 Index, which was 11201.75 at the end of February 2020, is now at 8597.75, a fall of 23.24% in a month. The more broadbased Nifty 500 has fallen by 24.24% during the same period. This fall is similar to the ones that we experienced in May 1992 (at the end of the famous Harshad Mehta bull run) and in October 2008 (the Lehman crisis). In May 1992, the market fell 22.68% and in October 2008, it fell 23.89%.

A fall of 23.2% is a very stiff one. The extent of the fall has been uniform across all stock markets in the world. The spread of the Covid-19 virus throughout the world has been rapid, and has put earlier calculations out of gear. Emergency responses, monetary, fiscal and otherwise, have been announced by various governments, including ours. We join all other countrymen and women in offering our prayers for the speedy return to some semblance of normalcy, a discovery of a vaccine/cure for this scourge, and also express our heartfelt gratitude to the members of the medical fraternity, workers in the sanitation departments, police forces, banking personnel, those engaged in transportation, the capital markets, especially those in the back office (including our own) and indeed everyone who has been rendering yeoman service at this time.

When an investor is suddenly confronted with a situation of such enormity, there are two responses possible:

- a. Take an extremely bearish view of the world, and sell all the stocks and go into other assets such as gold or cash.
- b. Calmly assess which businesses are likely to be less affected by this scourge (ALL businesses will be affected, only the degree, and the time taken to recover would vary) and re-align the portfolio accordingly.

We have chosen the second option, and these are our reasons for doing so:

1. We don't dismiss the severity of the situation, but we are confident that the WORST way to manage a portfolio is to sell in a panic, especially if the companies in the portfolio are strong and competitive.
2. This certainly isn't the first crisis to hit us, nor will it be the last. Even in our career, we have seen wars, assassinations, recessions, terrorist attacks, epidemics, natural disasters, scams and scandals, political uncertainties, and several other negative factors. We firmly believe that there are companies in India that have the abilities to withstand and outlive this problem, and our endeavour is to populate your portfolio with companies of this kind. We have from the beginning, attempted to do only this. Only now, the quoted prices are more in our favour than they were before.
3. We cannot estimate when the market bottom would be touched (and we don't believe that anyone can), but we can certainly assess the competitiveness of the companies concerned, and if such companies are suddenly available at prices 25-35% cheaper, these are prices to keep accumulating them, in instalments.
4. We believe that it is inconceivable that all businesses would be affected to an equal extent by this scourge. For example, while it is likely that companies involved in travel and tourism would be badly affected by this, we can safely assume that companies that make personal products like toothpaste or detergents, or pharmaceutical companies (especially ones that provide chronic therapies) would be affected less.

5. At the same time, it has always been our endeavour to stay away from stocks of companies that were exorbitantly priced. Even a very good business, purchased at very high prices, does not qualify as a good investment. Our portfolio PE multiple, even before this month's fall, was 19.75, and it has now fallen to 19.24 towards the end of March 2020 (after the new additions). It is almost certain that the Bloomberg EPS estimates for all companies would be sharply revised downwards for the next few quarters.
6. A sharply falling crude oil price is good news for an economy that depends upon imported oil to meet 85% of its requirements.
7. A good deal of the market's fall can be attributed to the unwinding of leveraged ETFs, and algo-based trading, that drove up the market in the first place.
8. FPI investments in India were sharply negative over the past month, but has just turned positive again. The domestic institutions almost continuously have acted as a counterbalance to the FPI outflows.
9. More than anything else, the statistics of your portfolio should provide confidence:

The overall statistics of your portfolio

Parameter	How does it fare?
Average age of companies in the portfolio	60 years
Weighted average Return on Capital	31.7%
Weighted average Debt/Equity (including financials)	0.37
Weighted average Debt/Equity (excluding financials)	0.05
Weighted average P/E multiple (*)	19.24

(*) The statistics are for the incumbent model portfolio as on 31st March 2020, based on the latest earnings estimates on Bloomberg. It is likely that these estimates would be revised downwards in the coming weeks.

Recent changes in the portfolio

We have made certain changes in the portfolio recently. This was brought about by sharp falls in the share prices of companies that we had earlier stayed away from, because of their high prices. Also, we have increased the portfolio weight of companies that we believe would be in a better position to compete in these tough times.

New additions to the portfolio:

1. Titan Company
2. Asian Paints

From a recent high of Rs.1,329 in mid-February 2020, the stock price of Titan had fallen suddenly to as low as Rs.800, and is now quoting at around Rs.917. We don't believe that the fall of 30% in the overall index is the same as a 30% fall in a stock like Titan. The company has a formidable reputation amongst organized jewellers, a nationwide distribution network, the ability to produce a wide variety of designs, enjoys the trust of the customer, and belongs to an industrial group known for its clean governance practices. We are confident that the company has the brand strength, the balance sheet strength and competitive ability to withstand this downturn. **A company like this is available at reasonable prices ONLY during such periods of panic.** Similarly, the stock of Asian Paints had corrected from a recent high of Rs.1,916 to a low of Rs.1,431 during this panic. A sharp fall of 25% in Asian Paints is a very very rare occurrence. The company is without doubt one of the best managed companies in the country with an enviable brand, distribution network, strong balance sheet, efficient working capital, pricing power and great management talent. It does, in our opinion, make eminent sense to pick up shares of companies like these (extremely competitive companies) at lower prices made available by the panic.

Other steps in the portfolio

We had, before the Covid-19 panic, bought some new shares in pharma, like Sun Pharma and Glaxosmithkline Pharma. We continue to hold on to them. We have increased the weight in companies like ITC and Indraprastha Gas, and are holding on to our positions in Colgate Palmolive, Bosch and Container Corporation. It seems highly unlikely to us that stocks like Sanofi, Sun Pharma and Glaxo, which focus mostly on chronic therapies, or companies like Colgate, Indraprastha Gas or ITC, would be affected to the same extent as other businesses that would be directly affected by the spread of the Covid-19 virus.

Dear Investor, you would have realized that almost all of our companies are close to zero-debt. Indeed, if we remove the financials from the calculations, the overall Debt/Equity ratio of our portfolio is 0.05.

When will the recovery come?

It would be presumptuous for anyone to hazard a guess on this aspect. There are simply too many factors to be considered. However, it is safe to assume that **some** companies would recover faster. In our own portfolio, we believe that these are some companies that would be less affected by the Covid-19 issues:

1. ITC
2. Colgate Palmolive
3. Indraprastha Gas
4. Sanofi India
5. Sun Pharmaceuticals
6. Glaxosmithkline Pharma

The second set of companies in the portfolio are the ones that would be affected by the Covid-19 pandemic to a greater extent compared to the list given above, but we are confident that these have inherent competitive strengths to ride out the tough times better than their competitors. Some of these are:

1. State Bank of India
2. HDFC Bank
3. Asian Paints
4. Titan Company
5. Bosch
6. Container Corporation of India

Every one of these companies is a market leader or a strong No.2. Every one of them has a long track record of profitability and cash flows, and has seen several market cycles. We are confident that every one of the companies in the two lists presented above (our portfolio) is capable of overcoming the present set of problems posed by the Covid-19 virus.

So, is the panic unjustified?

We don't claim to know better than the others, or exactly how things will pan out in future in terms of stock price movements. We don't even know if the bottom has been reached. But we do know one thing – **there are companies that are stronger and more competitive than others. The capital market usually favours investors who stick to such businesses. Added to that, the chances of success in investment is enhanced when such companies are purchased at reasonable prices.**

A panic situation is probably the ONLY time when such companies are available at sharply reduced prices.

For those investors who are in a position where the exposure to equity is low, we think that the present set of prices is an excellent opportunity to begin investments. Just think of this as a sale going on of highly acceptable merchandise. (Caveat: stick to high quality only)

Our approach has always been to stick to good quality businesses, when they are not too expensive. You would remember that we stayed away from highly hyped stocks just a few months ago, when almost the entire market was gung-ho about them. The reverse of that strategy is to buy into some of such stocks when there is an opportunity to buy them at far more reasonable prices (without bothering too much about when such stocks would sharply rise again).

Let's think of this as a journey through uncharted territory. The best thing to do under such circumstances is to have strong companions. A set of highly competitive companies, and reasonable prices, are as good a set of companions that we will ever get.

We wish you and your family safety and good health in these troubled times. Stay safe. Stay at home.

Warm regards

Yours sincerely,

(E A Sundaram)

Chief Investment Officer and Portfolio Manager

"We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful."

Warren Buffett

Top 10 Holding of o3 Core Value Strategy - Regular Scheme Option as on 31 st March 2020			Overweight / Underweight of Regular Portfolio Compared to Nifty 500 as on 31 st March 2020	
Name	GICS Sector	Weight		
ITC	Consumer Staples	6.38%		
Indraprastha Gas	Utilities	6.04%		
Colgate-Palmolive (India)	Consumer Staples	6.01%		
HDFC Bank	Financials	5.68%		
Sanofi India	Health Care	5.45%		
Oracle Financial Services Software	Information Tech	5.15%		
State Bank of India	Financials	4.60%		
Container Corporation of India	Industrials	4.48%		
Sundaram Finance	Financials	4.23%		
Castrol India	Materials	4.14%		
		52.16%		

	Underweight	Overweight
Industrials		18.08%
Health Care		5.15%
Consumer Discretionary		4.26%
Materials		2.04%
Utilities		0.81%
Real Estate	(0.59%)	
Consumer Staples	(1.24%)	
Communication Services	(3.04%)	
Information Technology	(6.57%)	
Energy	(9.83%)	
Financials	(11.07%)	

Investment Objective: The investment objective is to achieve capital appreciation through investment in a diversified portfolio of strong businesses, purchased at reasonable valuation.

Model Portfolio Details as on 31 st March 2020		Model Portfolio Composition as on 31 st March 2020	
Weighted Average ROCE	31.67%	Large Cap	48.5%
Portfolio PE (1 year forward PE, Based on FY21)	19.24	Midcap	43.5%
Portfolio Dividend Yield	1.78%	Small Cap	6.0%
Average Age of companies	60 Years	Cash	2.0%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 31st March 2020
- Midcap: Market cap below 100th company to the market cap of the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 31st March 2020
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 31st March 2020

Model Portfolio Composition as on 31 st March 2020	
Model Portfolio Over Lap with Nifty 500	15.31%
Model Portfolio Over Lap with Nifty 50	16.04%

Consolidated Portfolio Performance of Core Value Concentrated Strategy			Consolidated Portfolio Performance of Core Value Regular Strategy		
Period	31 st March 2020		Period	31 st March 2020	
	Portfolio	Nifty 500		Portfolio	Nifty 500
1 Months	(19.19)	(24.25)	1 Months	(20.53)	(24.25)
3 Months	(24.30)	(29.13)	3 Months	(24.90)	(29.13)
6 Months	(22.90)	(25.10)	6 Months	(23.16)	(25.10)
Since Inception (15/04/2019)	(21.51)	(28.47)	Since Inception (14/05/2019)	(21.48)	(23.62)

- Since inception date stated is considered to be the date on which the first client investment was made under the strategy

Disclaimer: Performance depicted is based on all the client portfolios existing as on such date, using Time Weighted Rate of Return (TWRR) of each client and then computing *arithmetic* average for the overall strategy. Past performance is no guarantee of future returns. The above portfolio performance is after charging of expenses (Custody Fee & Audit Fee adjustment is pending, the performance may change to it for some basis points).

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