



The Mills of the Gods

Dear Investor,

We keep getting queries, from investors and friends among the wealth advisors, as to why there is so much of a mismatch between the economic reality and the stock market. The disruptions caused by Covid-19, jobs lost, businesses rendered vulnerable, economic growth shrinking to its lowest level in decades, seem to have been shrugged off by the stock market that has sharply recovered in the last 6 months. Between the end of March 2020 and until the end of September 2020, the BSE Sensitive Index has risen by 29.18%, and has risen 46.5% from the lows of March.

Is it illogical? Is it rampant speculation? Well, we can't deny that there is an element of speculation in any stock market. But over a period of time, the stock market does reflect the economic reality. Very often, the expectations of what is likely to happen drive the stock prices well in advance of the actual event happening. The stock market and more specifically, individual stock prices, do swing from extreme despair to extreme exuberance. It is our job as investors to identify which stage of the cycle it is in and act appropriately. At the same time, there is a method to the seemingly mad ways of the stock market.

Let us discuss some examples:

Strong long-term correlation between stock market returns and the profit growth of the underlying companies:

In the 20-year period between March 2000 and March 2020, the cumulative net profits of the BSE 200 companies grew by 8.6% per annum. The BSE 200 Index grew by 9.2% per annum (Data source: www.bseindia.com). In the interim, we have seen wild bull markets, as well as very depressing bear markets.

There is no immediate cause-effect relationship in the stock market, but it does play out over a period of time.

Some of the most radical economic reforms this country has seen was presented in the 1993 budget by the then Finance Minister Dr. Manmohan Singh. Some of these reform measures were:

- Setting up of a separate board for Financial supervision within the RBI.
- Reforms in Capital markets - office of the controller of capital issues was abolished and all powers transferred to SEBI.
- Key sectors like power generation, telecom and road infrastructure were opened to private investment.
- Five year tax holiday was given for power generation and distribution.
- Custom duty was restructured in the area of capital goods and project imports:
 - Import duty was reduced on projects and general machinery from 55% to 35%.
 - Projects in priority sectors like power, coal mining and petroleum refining got a cut in duty rate from 30% to 25%.
 - To enable domestic players to compete, duty on components of general machinery was reduced from 40% to 25%.
 - For electronic industry, project imports and goods duty was reduced to a uniform rate of 25% from duty structure of 30% to 50%.
- In case of excise duties:
 - Special excise duty was removed and merged with basic excise duty rates.

- The excise duty on capital goods and instruments was reduced to a uniform rate of 10% from a range of 11.5% to 23%.
- For the power sector, the uniform rate was kept further lower at 5%.
- Excise duty on Commercial Vehicles was reduced from 23% to 15%.
- Excise duty was fully exempted on body building on chassis of buses and public transport vehicles.
- Excise duty was lowered on TV, Refrigerators.

These were extremely important economic reforms announced, and in many ways, they changed the way businesses were conducted in the country. But guess how the stock market reacted to such reforms? Over the next three years (between Jan 1993 – Jan 1996), the returns from the S&P BSE Sensex were about 3% per annum (Source: www.bseindia.com)

But several years later, the power sector, the financial services sector, the capital goods sector, telecom sector, all had their place under the sun with splendid returns to their respective shareholders. It had taken that long for the reforms of 1993 to have its impact on the stock market.

Index	Performance Between Dec 2001 – Dec 2007
S&P BSE Sensex	35.6%
S&P BSE Capital Goods Index	79.6%
S&P BSE Bankex*	48.9%
S&P BSE Auto	39.9%
S&P BSE PSU	50.3%

* Between Jan 2002 – Dec 2007

Source: www.bseindia.com

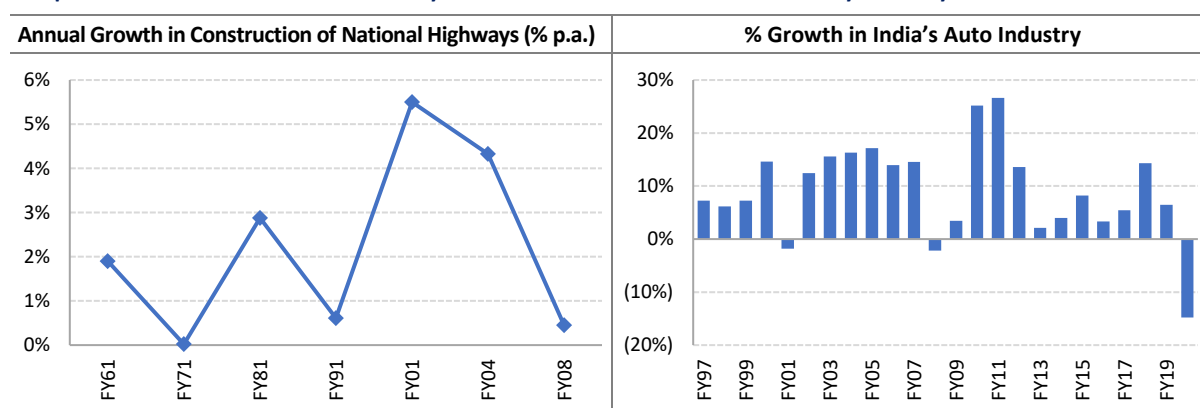
Change in patent laws in Indian Pharma industry

Until 2005, India did not protect product patents and gave protection only to process patents. The change in this law changed the trajectory of R&D spending among Indian pharma companies and saw a significant rise in investor interest in pharma stocks like Abbott, Sanofi and Pfizer several years later.

Price Performance Between (% p.a.)	S&P BSE Sensex	S&P BSE Healthcare Index
Dec 2001 – Dec 2005	23.4%	20.3%
Dec 2005 – Dec 2010	17.0%	16.7%
Dec 2010 – Dec 2015	5.0%	20.2%

Source: www.bseindia.com

Sharp increase in road construction activity led to a boom in the automobile industry several years later.



Source: (1) Ministry of Road Transport & Highways (2) SIAM

There can be no doubt that this sharp increase in availability of better-quality roads between 1998 and 2004 was one of the main reasons for the growth of the Indian automobile Industry several years later.

Other examples

- Large scale investments and infrastructure improvements in the telecom sector, broadband connectivity and falling computer hardware prices saw the rise of the IT services industry in India, including the BPO business and the offshore software development model.
- Changes in the demographic profile in the country over the past two decades have seen a boom in consumer spending, personal finance industry, e-commerce sites and the food delivery business.

All of these lead us to the conclusion that like the mills of God, the stock market may grind slowly, but it does grind very fine.

What about now?

These are the doubts that many investors have expressed, about the present status of our markets:

- a. GDP has contracted sharply, and is expected to contract for the full year 2020-21. Why is the market PE so high?
- b. Economic indicators are so depressing.
- c. There is so much strife that we see on television every day. India divided as never before. Will we ever see harmony in this country?
- d. All good companies are quoting at such high prices. We don't want to buy poor quality companies. What do we do?

Here are our responses:

- a. Yes, the GDP has contracted sharply this year. The credit rating agency Moody's has predicted that India's GDP growth rate this year (FY 2020-21) will be -11.5%. But the same Moody's has said that the country's GDP will bounce back to nearly 11% in the subsequent year. We are seeing positive growth already in rural India. As a forward-looking machine, much of this has been discounted by the market already.
- b. The monsoon rains this year have been close to normal. Added to this are the agricultural reform measures announced in May 2020 i.e., the changes to the APMC rules, the changes to the Essential Commodities Act, and the decision to permit contract farming etc, do augur well for the rural economy that supports more than 50% of the working population of the country.
- c. There are infrastructure projects like the dedicated freight corridors, the improvement in the railway infrastructure and port infrastructure, improvement in the electricity transmission and distribution sector and the strong possibility of multinational companies protecting their interests and having an additional sourcing point other than China are all good pointers towards a revival.
- d. The sharp fall in crude prices is really good news for a country that imports more than Rs.843000 crores of crude oil and petro products. A 20% fall in the crude price means that India saves about \$20 billion this year on the crude import bill.
- e. Not all good quality stocks are expensive. In our opinion, even today, there are several stocks that represent companies of high quality are available at very reasonable prices, and many such companies are in our portfolio. Investors need not make the mistake of believing that only that which goes up in stock price is a good company.
- f. Our television channels have the habit of blowing up stories out of proportion. Yes, there are strifes that happen in the country and they are unfortunate, but they are nowhere as bad as being made out in our television debates. Let us not forget that the level of individual freedom in this country is probably better than 90% of the countries in the world. Of course, there are warts and flaws in our system, and some areas desperately need reforms. But we have no doubt that positives in this country outweigh the negatives.

In conclusion, there are reasons to be confident about the economic future of our country, while at the same time, being careful about which companies we choose, and at what price we buy into them.

The stock market does remind us of the mills of the Gods. They may grind slowly, but they do grind very fine. And as the great Warren Buffett has reminded us, unlike God, the stock market does not forgive those who know not what they do!!

Warm regards

Yours sincerely,

(E A Sundaram)

Chief Investment Officer and Portfolio Manager

Top 10 Holding of o3 Core Value Strategy - Regular Option as on 30 th September 2020			Overweight / Underweight of Regular Portfolio Compared to Nifty 500 as on 30 th September 2020	
Name	GICS Sector	Weight	Underweight	Overweight
ITC	Consumer Staples	6.20%	Industrials	14.20%
Oracle Financial Services Software	Information Tech	5.10%	Consumer Staples	4.21%
Colgate-Palmolive (India)	Consumer Staples	4.70%	Health Care	3.48%
HDFC Bank	Financials	4.70%	Consumer Discretionary	3.45%
Container Corporation of India	Industrials	4.61%	Materials	2.38%
Blue Dart	Industrials	4.14%	Utilities	0.65%
State Bank of India	Financials	4.10%	Real Estate	(0.53%)
Multi Commodity Exchange of India	Financials	3.90%	Communication Services	(2.83%)
Bosch	Consumer Discre	3.88%	Information Technology	(7.86%)
Indraprastha Gas Ltd	Utilities	3.57%	Financials	(10.79%)
		44.90%	Energy	(12.36%)

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

Regular Model Portfolio Details as on 30 th September 2020		Regular Model Portfolio Composition as on 30 th September 2020	
Weighted Average ROCE	29.47%	Large Cap	42.5%
Portfolio PE (1 year forward PE, Based on FY22)	24.81	Midcap	39.0%
Portfolio Dividend Yield	2.24%	Small Cap	12.5%
Average Age of companies	59 Years	Cash	6.0%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 30th September 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 30th September 2020
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 30th September 2020

Regular Model Portfolio Composition as on 30th Sept 2020

Model Portfolio Overlap with Nifty 500	12.57%
Model Portfolio Overlap with Nifty 50	13.05%

Consolidated Portfolio Performance of o3 Core Value Strategy Concentrated Option			Consolidated Portfolio Performance of o3 Core Value Strategy Regular Option		
Period	30 th September 2020		Period	30 th September 2020	
	Portfolio	Nifty 500		Portfolio	Nifty 500
1 Months	(0.25)	(0.32)	1 Months	0.19	(0.32)
3 Months	5.56	10.23	3 Months	7.48	10.23
6 Months	22.02	33.52	6 Months	27.40	33.52
1 Year	(7.19)	0.01	1 Year	(2.37)	0.01
Since Inception (15/04/2019)	(4.19)	(3.10)	Since Inception (14/05/2019)	0.27	1.43

- 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 adjustment is pending, the performance may change to it for some basis points).

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