

**The discussion around the Index, and its relevance**

Dear Investor,

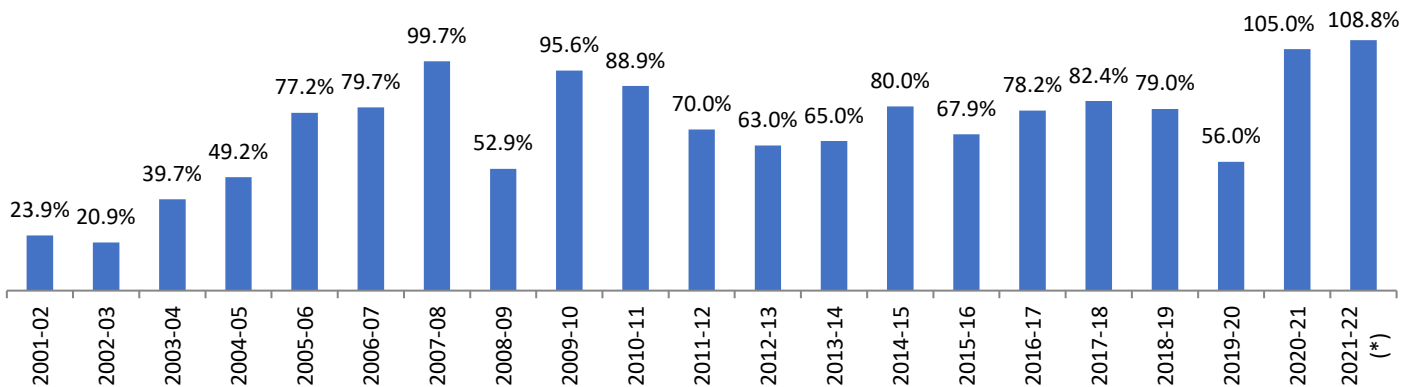
Quite often nowadays, conversations veer around the stock market’s movement. There is enthusiasm, widespread participation, many newer participants (armed with the comfort of Internet-based trading), record collections by domestic mutual funds, robust Initial Public Offering (IPO) markets and, inevitably, the questions about whether it can sustain at these levels, and what should any Investor do? We attempt to answer some of these questions in this edition of our Newsletter.

There are several points that an Investor must keep in mind:

**Sensex at 57000+ and Nifty 50 at 17000+**

The numbers 57000 or 17000 by themselves have no relevance unless compared to some other metric like the underlying earnings or overall economic activity. One famous method expounded by the great Warren Buffett is the ratio of Market Capitalization to GDP. This chart below gives that data for the Indian market, and it makes interesting reading.

**India - Mkt Cap/GDP Ratio**



Sources (1) Bloomberg (2) Economic Survey.

Please note that for the year 2021-22, the following assumptions have been made (a) the market capitalization of NSE is assumed to be the same in March 2022 as it was in August 2021 and (b) India’s GDP is assumed to grow in nominal terms by 18% (from a low base caused by the pandemic) in this fiscal year.

If India’s GDP grows by 18% (in nominal terms) next year, the valuation of the stock market is 108.5% of GDP, and this is higher than the previous high touched in 2007.

The rolling 5-year average figure for the Market Cap/GDP ratio is 86.2%, and the rolling 10-year average is 78.5%.

As a point of interest, the market cap/GDP ratio of the US stock market (Wilshire Total Market Index/GDP) is 207.2% at the end of August 2021.

A direct comparison with the US may not be completely relevant. What is relevant is how this ratio has moved from the depths of the pandemic-induced panic in March 2020.

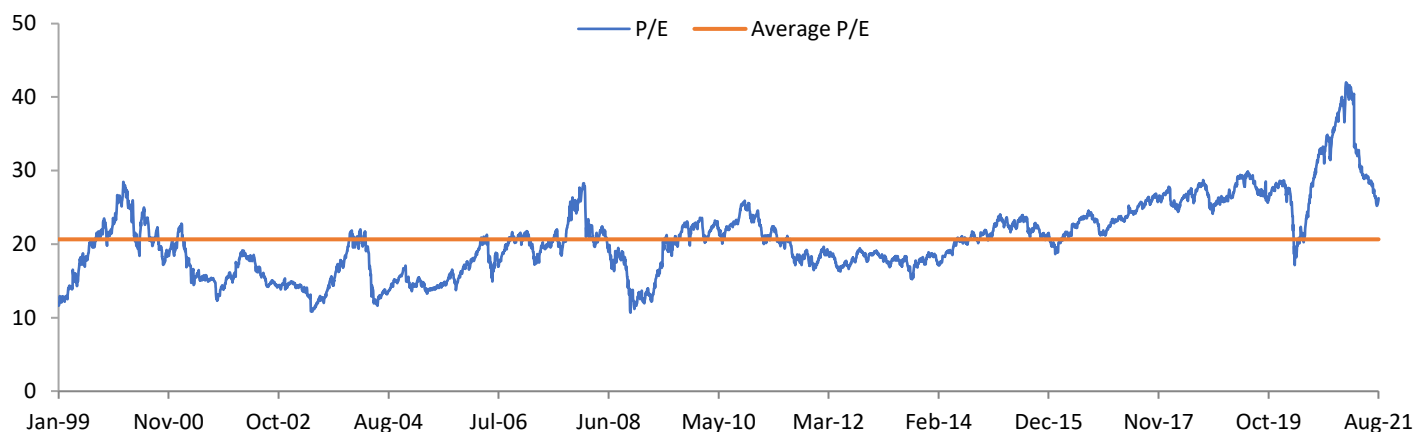
Growth in India’s Market cap/GDP ratio from the low of March 2020 till Aug 2021 – 94%

Growth in the US Market cap/GDP ratio from the low of March 2020 till Aug 2021 – 72%.

## Valuation in PE Terms

The valuation history of the broad-based Nifty 500 index in PE terms is given below:

### Nifty 500 Index - PE History



Source: NSE.

The Nifty 500 has moved up sharply since the middle of last year, with mid and small cap stocks rising faster. The earnings have also improved since the lows of the pandemic last year, leading to a reduction in the PE multiples. Overall, the market valuation is still above its long-term average of around 21 times.

### The Rotational Nature of Popularity of Sectors Within the INDEX

The market is not a monolithic entity. Some sectors (and stocks) become very popular and acquire a large weight in the Index. Some others lose their popularity. Popularity can be measured by its valuation, and by the changing weight within the index. A high weight for a sector indicates high popularity, and therefore high expectations from the sector.

### Nifty 50 Sector Weight

Sector	Dec-02	Dec-07	Dec-12	Dec-17	Jun-19	Dec-20	Jun-21	Aug-21
Auto	5.6%	3.4%	8.8%	10.6%	5.7%	5.4%	5.3%	4.6%
Capital Goods	3.1%	10.5%	5.9%	3.8%	4.0%	2.6%	2.7%	2.7%
Cement And Cement Products	2.4%	2.1%	4.2%	1.6%	1.7%	2.2%	2.5%	2.5%
Consumer	17.9%	3.6%	12.3%	9.2%	10.7%	11.5%	11.1%	11.1%
Financial Services	11.7%	12.0%	29.5%	35.0%	40.4%	38.8%	37.2%	37.6%
Health Care	8.3%	2.2%	5.0%	4.0%	2.2%	3.6%	3.6%	3.5%
Media & Entertainment	1.2%	0.4%	0.0%	0.8%	0.4%	0.0%	0.0%	0.0%
Metals & Mining	2.9%	9.0%	3.8%	4.5%	3.6%	2.5%	3.6%	3.8%
Oil & Gas	17.6%	25.4%	12.3%	12.7%	12.1%	12.5%	11.7%	11.4%
Others	0.9%	2.3%	0.3%	1.5%	1.4%	1.0%	1.4%	1.3%
Technology	24.2%	9.5%	11.4%	11.4%	13.7%	16.3%	17.4%	18.0%
Telecommunication	2.6%	11.4%	2.0%	2.4%	1.8%	2.0%	1.8%	2.1%
Utilities	1.6%	8.2%	4.5%	2.4%	2.3%	1.6%	1.7%	1.6%

Source: NSE

Discussions centred around the Index, while important, tend to miss out on the relative valuations of different sectors and stocks in the index, and in the market. Not all stocks or sectors are equally expensive, even if the overall Index seems expensive.

## The Investors' Choices

There are several choices available to the investor. None of these choices is superior to any other. What is important, in our opinion, is to choose 4 or 5 equity products that are reasonably different from one another, so that the risk is spread out adequately. Done this way, these products will not rise together, nor fall together, and that is a good thing.

### Participation in the market through ETFs, Index Funds, or other products with a high correlation with the Index

Most of the discussion around the “market’s valuation” implicitly revolves around the valuation levels of the Index. For those investors choosing to participate in the market through this route, the following points may be relevant:

- (a) If the intention is ONLY to participate in the upward move so long as it lasts and getting out at the sign of a market reversal, it is advisable to be very careful. Not all investors have the time and agility to spot a reversing trend correctly.
- (b) If the investment is part of the well-considered overall asset allocation to equity, the ideal method would be to stagger the purchase over several equal instalments, so that the price risk is spread out.
- (c) An ETF and an Index fund have an advantage that other products do not. They have a much lower cost structure. In the long run, this is a significant advantage. They are also not dependent upon any single individual.

### Products Benchmarked to Other Indexes

The most popular indexes in India are the Nifty 50 and the S&P BSE Sensitive Index. It is natural therefore that the bulk of the index funds and ETFs revolve around these two indexes. However, the investor’s interests are better served by choosing products that are not aligned to the Nifty 50 or Sensex alone.

The investor has a plethora of choices, ranging from the Junior Nifty (companies ranked 51-100), the BSE 200 (the top 200 companies), the Midcap Index (companies ranked 101-250 in market capitalization), the small cap Index (companies ranked below 250 in market capitalization), and several sector indexes. There are ETFs and/or products that have been benchmarked to these various indexes that the Investor can choose from.

### Investment on the Company’s Merit Alone, Without Considering the Index At All

We also wish to highlight the aspects about the active management products available in the market that steer their own course, based upon the individual company’s merit as an investment case. Such products (o3’s Core Value Portfolio being a good example), pay less attention to the Index, but concentrate far more on the individual company’s strengths and valuation. Such products take advantage of the fact that because of their very nature, several important choices are missed out by investment strategies that pay too much attention to the Index.

A stock becomes part of the Index primarily based on its price movement (and its free float market capitalization). The higher the price, the greater the weight in the index, and the greater the chance of institutional participation. It is also a fact that the higher the price, the greater the level of expectation and enthusiasm that surrounds the stock.

### Buying Popular Stocks When the Index is at a High

Let us look at two instances of a market high, i.e., March 2000, and December 2007. Both instances were characterized by extremely bullish index movement, and a domination of a few select sectors. The 2000 bull run was fuelled by IT, Telecom and Entertainment stocks, and the 2007 bull run was fuelled by Infrastructure and Real Estate stocks.

**Performance of popular stocks of 2000 (the index high fuelled by the IT boom)**

Company	5-year average PE as on 31-03-2000	PE as on 31-03-2000	Subsequent stock price performance (CAGR %) for the next 5 years (Mar 2000-Mar 2005)
GTL Ltd	6.70	40.10	(47.3%)
Infosys Ltd	28.25	94.48	(1.4%)
Wipro Ltd	37.60	192.13	(19.5%)
Visualsoft Tech (*)	88.92	241.73	(57.8%)
Zee Ent	50.05	305.05	(33.3%)

(\*) Visualsoft was listed only in Nov 1998. Data source: ACE Equity.

**Performance of popular stocks of 2007 (the index high fuelled by Real Estate & Infrastructure)**

Company	5-year average PE as on 31-12-2007	PE as on 31-12-2007	Subsequent stock price performance (CAGR %) for the next 5 years (Dec 2007 - Dec 2012)
Unitech	10.19	60.40	(41.3%)
DLF (*)	20.31	32.70	(26.7%)
Jai Corp	21.56	356.82	(43.5%)
Larsen & Toubro	13.52	42.91	(4.9%)
Reliance Industries	9.89	25.01	(10.3%)

(\*) DLF was listed only in July 2007. Data source: ACE Equity.

This does not mean that there were no decent investment opportunities at the peak of the Index in March 2000 or March 2007. Here are a few prominent examples:

**Performance of unpopular stocks purchased during the peak of the IT Boom**

Company	Mkt cap (Feb 2000) (INR cr.)	Mkt cap (Dec 2007) (INR cr.)	CAGR (%)
Nestle India Ltd	3,336	14,461	20.6%
ITC	19,952	78,856	19.2%
Asian Paints	1,504	10,576	28.3%
State Bank of India	13,000	124,793	33.5%
Hindalco	5,883	26,365	21.1%
Larsen & Toubro	9,568	121,331	38.3%

Sources: Bloomberg, ACE Equity and BSE.

**Performance of unpopular stocks purchased during the peak of the Infra/Real estate boom**

Company	Mkt cap (Dec 2007) (INR cr.)	Mkt cap (Jun 2017) (INR cr.)	CAGR (%)
GSK Consumer	3,094	22,500	23.2%
Procter & Gamble	2,544	26,119	27.8%
Hindustan Unilever	47,179	234,108	18.4%
Asian Paints	10,576	105,910	27.4%

Sources: Bloomberg, ACE Equity and BSE.

The point, dear Investor, is that opportunities for good investing can come irrespective of the level of the Index. What really matters is that we choose companies that retain their ability to compete effectively in the marketplace and buy stocks of such companies when they are clearly not exorbitantly valued.

And if we buy a portfolio of such companies, it may be inevitable that one or two may not move the way we want, but if most of them move after a while, the returns are decent enough, while at the same time, maintaining exposure to different stocks compared to the Index or other investment products. This provides the investor a decent option of diversification.

In conclusion, an Index is useful in understanding the extent of optimism displayed towards different sectors. It is also a useful barometer of the overall stock market. **It is useful to the extent that it gives us an idea about what the rest of the market thinks. It should never replace our own thinking.** An index, or products closely aligned to an index, should never be the ONLY equity products considered by the Investor. The purpose of this newsletter is to bring to your awareness about a different way to invest, equally effective in the long run, but treading a different path.

Happy Investing.

Warm regards,

Yours sincerely,

**(E A Sundaram)**

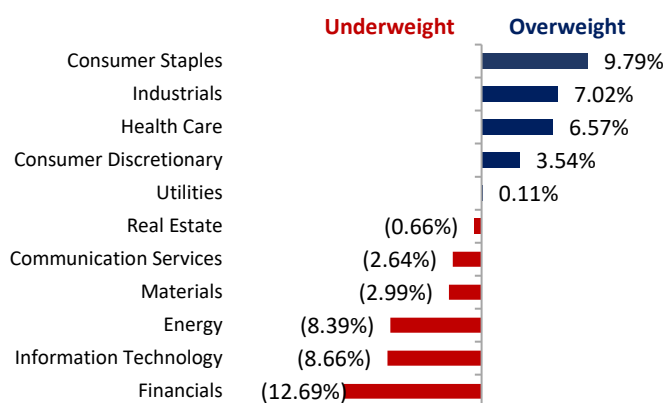
*Chief Investment Officer and Portfolio Manager*

**“All financial success comes from acting on a plan. A lot of financial failure comes from reacting to the market”**

**- Nick Murray**

**Top 10 Holding of o3 Core Value Investment Approach - Regular Option as on 31<sup>st</sup> August 2021**

Name	GICS Sector	Weight
ITC	Consumer Staples	6.03%
Oracle Financial Services Software	Information Tech	5.84%
Asian Paints Ltd	Materials	4.79%
Computer Age Management Services	Information Tech	4.77%
Colgate-Palmolive (India)	Consumer Staples	4.38%
Sanofi India	Health Care	4.29%
Sun Pharmaceutical	Health Care	3.90%
Cummins India Ltd	Industrials	3.85%
Indraprastha Gas Ltd	Utilities	3.83%
HDFC Bank	Financials	3.70%
		<b>45.38%</b>

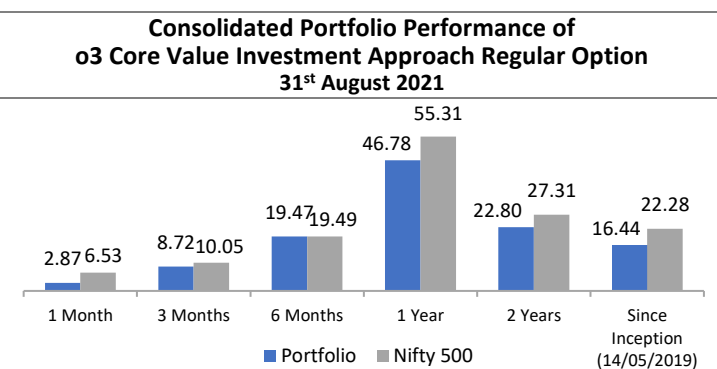
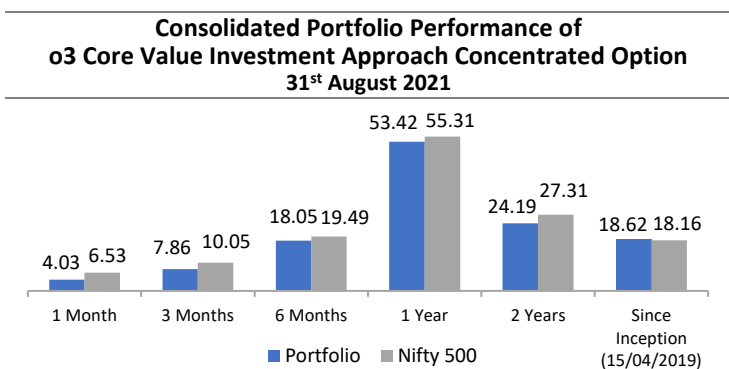
**Overweight / Underweight of Regular Model Portfolio Compared to Nifty 500 as on 31<sup>st</sup> August 2021**


**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 31 <sup>st</sup> August 2021		Regular Model Portfolio Composition as on 31 <sup>st</sup> August 2021	
Weighted Average ROCE	25.40%	Large Cap	39.0%
Portfolio PE (1 year forward PE, Based on FY23)	26.36	Midcap	34.5%
Portfolio Dividend Yield	1.79%	Small Cap	17.5%
Average Age of companies	63 Years	Cash	9.0%

- Large Cap: Market cap of the 100<sup>th</sup> company in the Nifty 500 (sorted by market cap in descending order) as on 31<sup>st</sup> August 2021
- Midcap: Market cap below 100<sup>th</sup> company to the market cap of the 250<sup>th</sup> company in the Nifty 500 (sorted by market cap in descending order) as on 31<sup>st</sup> August 2021
- Small Cap: Market cap lower than the 250<sup>th</sup> company in the Nifty 500 (sorted by market cap in descending order) as on 31<sup>st</sup> August 2021

Regular Model Portfolio Composition as on 31 <sup>st</sup> August 2021	
Model Portfolio Overlap with Nifty 500	16.46%
Model Portfolio Overlap with Nifty 50	18.80%



- Benchmark is Nifty 500, the portfolio is spread across different market capitalization, hence Nifty 500 is chosen as benchmark
- Since inception date stated is considered to be the date on which the first client investment was made under the investment approach

**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. *The performance related information provided here is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document.*

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