MONEYLIFE ADVISORY
MAS WEALTH

Regime Change or More of the Same?

Dear Fellow Investors,

At this time last year, we hadn't even completed four months of operations. And suddenly we faced an unprecedented scare scenario, when Covid-19 hit us. Fortunately, our portfolio, like that of several others, has come out rather well from that turmoil. The reason is we make a strong effort to not confuse between stock prices, external events, and different opinions about those events. Money is made from stock price movements, not from opinions no matter how right they may be. This helped us to get bullish early in the rally.

However, all that is past. The question that should be uppermost in everyone's mind is what kind of returns can we expect next year? Was last year a fluke? Those who have earned high returns last year would not want to give up those returns. Those who are coming into the fund now, would be worried about investing when the market that has run up a lot and may correct. These are indeed the most important questions now, which, I assure you, dominate my mind as well. The answer perhaps lies in the kind of market climate we face. Here are my thoughts, keeping in mind my firm belief that the market will fool the majority of people almost all the time and we need to stay focused on our formula of good quality stocks, which are on an uptrend.

Market climate

For starters, bullishness is palpable. The valuations at which IPOs are being launched, and the high P/Es of many stocks with average growth prospects, are signs. We have got used to large gains from just about any sector (steel, chemicals, pharma, software, auto, finance, banks, cement...) and so it is hard for us to see last year's trajectory was not normal. But human minds love to extrapolate, especially the positive events. Combine that with our natural tendency to hope for the best, and most of us would be unprepared for a negative surprise. Investors are not prepared for a year of low, or average, returns. This does not mean that stocks will fall. As long as interest rates are low, stocks will have natural tendency to rise. But many stocks will keep grinding sideways without making any headway.

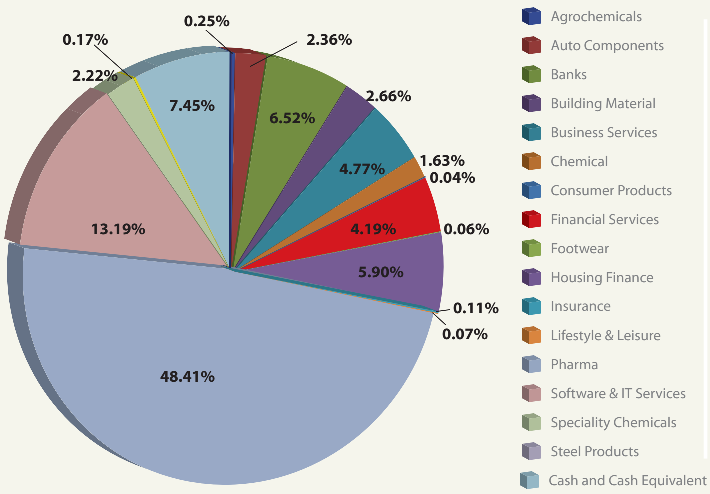
From time to time there may be a spectre of rising inflation and bond yield and maybe slowdown in growth. In that situation, expect a quick 5%-7% market decline when poor quality stocks (PSUs, cyclicals, low-return companies) would go down more. This would be followed by a short upmove that retraces the previous decline and only a bit more. If you check the 2018 and 2019 market moves, you would know what I mean. So, I feel the higher probability is that index would slowly trend higher. The second possibility is a continued strong rally, with the index up by say 25%-30% or so by end of the next financial year. For this to happen, banks and Reliance will have to do well again. The third possibility is a sharp decline. Given the low interest rates and that strong corporate profits (mysterious growth and huge cost savings from the lockdown and work-from-home) this may be a low-probability event. But then what we do know about the future?

How to play for FY22?

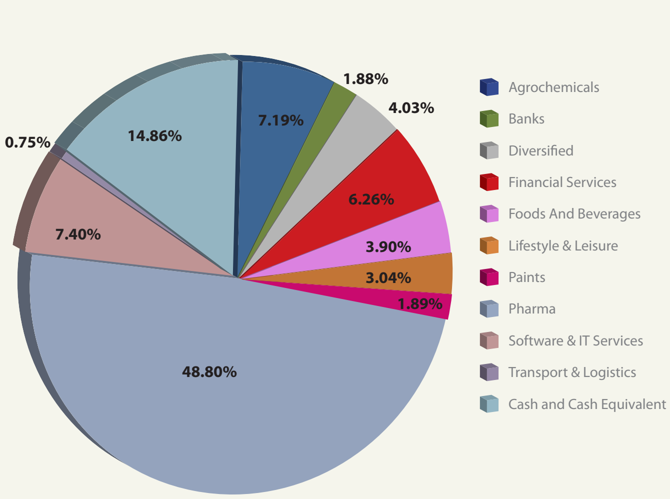
Since my objective is absolute, not relative return, how would we play a mildly, not wildly bullish, market? As we have done last year, we would ignore the index and index stocks, and focus on sectors where growth is strong, and enthusiastic and innovative management is taking advantage of that growth to take their businesses to new heights. These are pharma, speciality chemicals, software, ecommerce and building materials and very select banks/finance companies. This would be the core of the portfolio (70%-80%) but there is no hard and fast rule about that.

Many high-quality stocks have already run up and run the risk going sideways or even down on temporary disappointment. Hence, we intend to deploy a second strategy. Would not hold on to a 100% stock portfolio with unchanged exposures and sit back. We hope to increase our exposures to certain stocks when the market is down and lighten up when the market is up, since the assumption is that the market is not likely to keep heading relentlessly higher, like last year. This variation of exposures would apply to 20%-30% of the portfolio. Here is our latest sector-wise exposure to stocks. For the planned variable exposures, we are likely to add large-cap stocks from the software, consumer, cement, chemicals and financial sectors.

Sector wise exposure - Growth



Sector wise exposure - Prime



Another point about this strategy is that at no stage will we stray away from the stock selection process. At any time, you will see only the best quality stocks in your portfolio, picked up from a pre-selected list of about 150 stocks. How we do we define high quality? This is easy for us. Through years of research we have arrived that the following parameters that define quality: high margins, high cashflow return on capital, high conversion of profits to cash and low or no debt. While we use several parameters, here is a table that shows where our companies are on a simple score of margins, vis-a-vis Nifty 50 stocks.

	GPM	OPM	NPM
Prime	48%	24%	15%
Growth	45%	36%	16%
Nifty	44%	12%	8%

I do hope with this strategy, your portfolio will continue to do well to justify the faith you have placed on us.

Debashis Basu,
Founder & Principal Officer