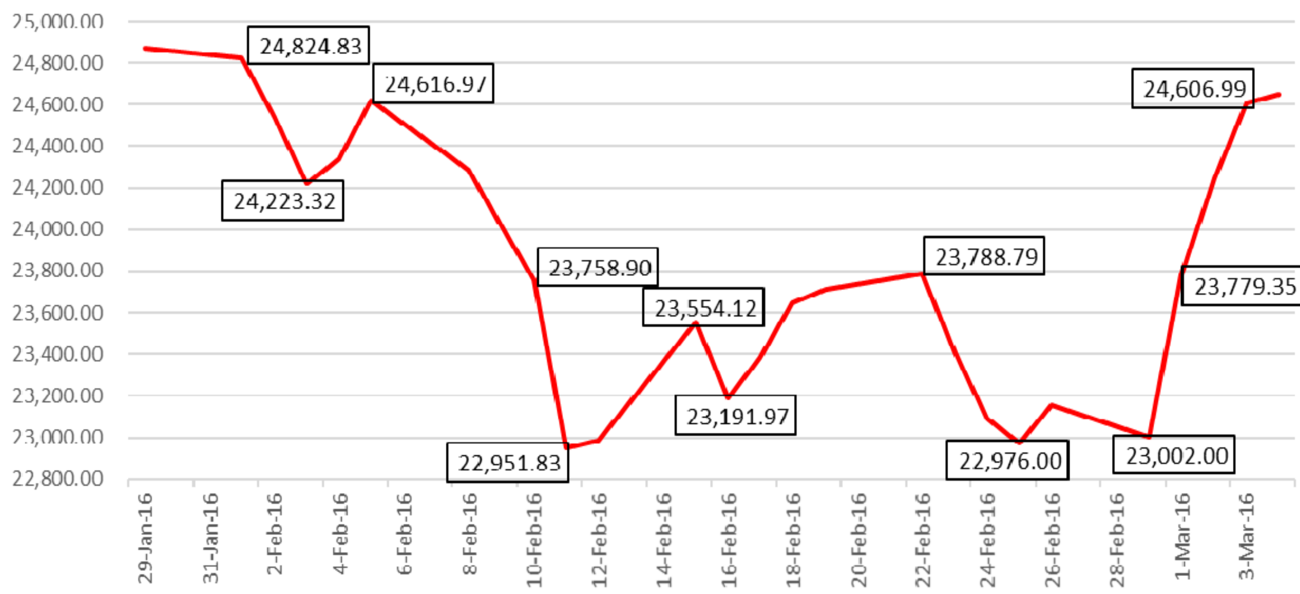
For Private Circulation ***4th March, 2016***

Deeper Correction in February



Steep Decline in February, we Underperform the World Markets

The sharp decline in our markets which started since January, gathered momentum and for the month of February, the Sensex fell by 7.51 %. Post Budget, for the first four trading sessions in March, there was a spike up in markets, with the broad market index appreciating by 7.18%, but for the year so far, the Sensex is still down 5.63 %. From its previous top of 30,024 in March 2015, the BSE benchmark index has seen a steep correction of nearly 18%.

The most distressing part of the fall in February was our underperformance *vis-à-vis* other global markets (see table). With the exception of the Japanese market, which fared worse than us, all other large markets outperformed us by a decent margin.

Index	Country	29-01-16	28-02-16	% Change
Bovespa	Brazil	39,331.91	42,793.86	8.80%
Jakarta Composite	Indonesia	4,615.16	4,770.96	3.38%
Strait Times	Singapore	2,629.11	2,666.51	1.42%
Dow Jones	USA	16,466.30	16,516.50	0.30%
FTSE	U.K.	6,083.79	6,097.09	0.22%
S&P 500	USA	1,940.24	1,932.23	-0.41%
NASDAQ	USA	4,613.95	4,557.95	-1.21%
CAC	FRANCE	4,417.02	4,353.55	-1.44%
Shanghai Composite	China	2,737.60	2,687.98	-1.81%
Hang Seng	Hong Kong	19,683.11	19,111.93	-2.90%
DAX	Germany	9,798.11	9,495.40	-3.09%
Nifty Midcap 100	India	12,469.10	11,558.70	-7.30%
BSE Sensex	India	24,870.69	23,002.00	-7.51%
S&P CNX Nifty	India	7,563.55	6,987.05	-7.62%
Nikkei - 255	Japan	17,518.30	16,026.76	-8.51%

Even the emerging markets of Brazil and Indonesia, which are predominantly commodity based economies, did significantly better than the Sensex and the Nifty. India is the world's fastest growing economy and lower commodity prices have boosted the government finances and reduced our trade deficit, then why the underperformance? What is the reason for the relentless selling by FIIs, which has aggregated Rs. 19,458.65 in the first two months of 2016?

Reasons for Under-performance and FII Selling

There are no easy answers especially when one considers that most international brokerages have a positive view on India and yet our markets, continue to sink. Our assessment, based on feedback from global fund managers is that

1. Several Emerging Markets (EMs) Funds were overweight India as compared other EMs.
2. The turmoil in China, sharp decline in crude oil prices and the prospects of higher interest rates in US resulted in a risk off trade and that triggered a selling in EMs.
3. Since fund managers were overweight India, we bore the brunt of selling led by redemptions in EM funds due to the risk off trade.
4. Despite the improving macros, corporate profits of the large index companies is stagnant and below expectations. This in itself was a reason to reduce India weightage.

Therefore, a culmination of redemption in EM funds as well as a strategic decision by fund managers to reduce their India weightage (due to flat corporate profits) resulted in the underperformance of our markets.

This scenario is extremely worrisome as FIIs are the largest investors in our markets with $ 257 billion of holdings of Indian equities. Furthermore there are no credible signs of an improvement in corporate profits which could excite them. If redemptions in EMs were to continue, then there is no guessing how much FII stock still remains in queue for offloading. The ability of domestic investors to absorb FII selling is limited and our markets could crack even further if the trends discussed above persist.

Change of FII Stance on India?

The only way this delicate position of ours can reverse is if

- EM fund redemptions subside
- Corporate profit growth picks up and
- Global money managers are comfortable with the India weightage in their portfolios.

A glimmer of hope that perhaps this positive scenario could fructify was visible in the first week of March. FII selling reversed and in the 4 trading sessions of March they pumped in a sizable Rs. 6506 crores. Could it be that the redemption pressure was easing? Is it that the outlook for corporate profits growth had improved?

There are signs that point in that direction.

Shanghai Composite and Crude Oil Markers have Stabilized

Since the risk off trade and the resultant selling by global investors was prompted by the slide in Chinese markets and crude oil prices, a pullback / stability in these markets could calm nerves and prevent further outflows. The positive news is that both Chinese stock markets and crude oil prices have steadied. The Shanghai Composite Index had crashed by 28.40 % from its December 2015 high of 3684.57 to 2638.30 on 27th January, 2016. Since then, it has moved sideways for over a month, testing the 27th January low again on 29th February but not breaching it. Currently, it about 9 % higher at 2874.15 (04/03/16) and it could be said that the worst is over, for the time being, for this market.

Crude oil markets too seemed to have turned around with the present Brent crude oil price of $36.94/barrel higher by 32.49% from its January low of $27.88/barrel. Since both markets, which had been the source of worry for global investors, have calmed down, there is a case for the risk off trade to end and the risk on trade to begin and that could be very positive for India.

Budget a Dampener but could Provide Room for Interest Rate Cut

The other concern of FIIs is tepid corporate profit growth. This could get partially addressed by Budget, which according to us was a dampener, but there were two noteworthy positives. Firstly, government spending was stepped up in infrastructure and rural development and secondly, the fiscal deficit at 3.5 % was in line with the FRBM Act, paving way for another cut in interest rate by the RBI. Both these factors are positive for India Inc. and could give corporate performance a leg up. The plan to recapitalize PSU banks and RBI's permission to include real estate as part of tier I capital was well received by the street and did boost this worst performing sector in our equity markets.

Our View on the Markets

Our view on the markets so far had been extremely cautious. In our previous newsletter we had stated:

'The two important indicators we are watching to foresee a turnaround is the Shanghai Composite Index and crude oil prices. These markets have to stabilize before we can conclude that the worst is over and time is ripe to once again invest in stocks. Till then investors are advised to bid their time and take advantage of this correction to improve the quality of their portfolios.'

The current trends do indicate that these markets have found their equilibrium at lower levels and therefore, investors may consider increasing exposure to equities in a gradual manner. There are many risks, but an interest rate cut, favorable monsoons and the outside chance of the GST being passed by the Rajya Sabha could lift sentiment. The key number to watch out for is the net FII flows. We will remain positive on equites so long as these are neutral or positive. Our view would instantly reverse if selling from this highly influential class of investors resumes.

Our topic of discussion this time in the Smart Investing Series of articles is *"Buying Secular Growth Stories"*

The returns generated by us for our Portfolio Management Investors are as under:

ANNUALISED RETURNS AS ON						04-03-16
Date from	**03-02-16**	**04-12-15**	**03-09-15**	**05-03-15**	**05-03-13**	**06-03-11**
	1MONTH	**3 MONTH**	**6 MONTHS**	**1 YEAR**	**3 YEAR**	**5 YEAR**
Elixir Equities Portfolio Performance	**-2.26%**	**-7.16%**	**-5.12%**	**-7.39%**	**20.59%**	**14.66%**
SENSEX	**0.49%**	**-4.74%**	**-3.63%**	**-16.10%**	**4.88%**	**2.29%**
NIFTY	**0.45%**	**-4.77%**	**-3.46%**	**-16.01%**	**4.99%**	**2.62%**
Performance comparison	**-2.75%**	**-2.42%**	**-1.66%**	**8.62%**	**15.60%**	**12.04%**
(higher of Sensex and Nifty)						

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SMART INVESTING – IV
- Buying Secular Growth Stories

ELIXIR EQUITIES PRIVATE LIMITED

Identifying Multi-Baggers

In our earlier discussion on Buying Midcaps as Options, we had stated that quality of research for identifying multi bagger is very important. Understanding which businesses have the potential to become multi-baggers could be extremely rewarding in the long run.

For the average investor, this presents a challenge as they may not have the time or the skillset for selecting stocks which can deliver good returns and eventually turn out to be multi-baggers. Smart Investing has a solution to this problem which could be implemented by investors with some application of time and effort.

Consistent Performers deliver Extra-ordinary Returns

The most important aspect of a company, whose share price delivers superlative returns in the long run, is consistent growth. Such companies are in a secular growth mode and this situation is ideal for investors seeking high returns with limited risk. As profits compound year after year, the stock price also moves up. There is also the added benefit of expansion of Price Earnings (PE) multiple as investors are prepared to pay a higher PE for a company where the Earnings per Share is steadily rising. The end result is swift appreciation in stock price due to the EPS rising and PE expanding.

Definition of Earnings Per share (EPS)

*Earnings per Share is the company's profit divided by its number of common outstanding shares. If a company earning $2 million in one year had 2 million common shares of stock outstanding, its **EPS** would be $1 per share.*

Definition of Price Earnings (PE) Multiple

The price earnings multiple / ratio is a tool for valuing a company. It measures its current share price relative to its earnings per share. The price-earnings ratio can be calculated as: Market Price / Earnings per Share

Examples of Companies in secular Growth Phase

Past multi-baggers like Sun Pharma, Infosys, HUL, ITC, Larsen and Toubro were in a secular growth trajectory when their stock price was doubling and tripling.

By seeking out companies which are consistently reporting steady growth in revenues and profits, an investor will be able to identify secular growth stories.

Examples of companies with Secular Growth Delivering Multi-Bagger Returns:

Secular Growth - Multi-bagger Returns

Sun Pharma						HDFC Bank				
Year	Net Profit	Growth (%)	Year End Price (BSE)	Annual appreciation		Year	Net Profit	Growth (%)	Year End Price (BSE)	Annual appreciation
2000-01	135.32		13.53			2000-01	210.52		46.00	
2001-02	174.31	28.81%	16.75	23.80%		2001-02	297.58	41.35%	47.03	2.24%
2002-03	228.56	31.12%	13.53	-19.22%		2002-03	386.87	30.01%	46.75	-0.60%
2003-04	233.98	2.37%	32.50	140.21%		2003-04	509.80	31.78%	75.67	61.86%
2004-05	299.86	28.16%	47.14	45.05%		2004-05	665.42	30.53%	108.85	43.85%
2005-06	450.94	50.38%	86.64	83.79%		2005-06	870.59	30.83%	154.70	42.12%
2006-07	612.95	35.93%	105.40	21.65%		2006-07	1,142.13	31.19%	189.88	22.74%
2007-08	1,001.61	63.41%	123.14	16.83%		2007-08	1,589.77	39.19%	263.99	39.03%
2008-09	1,239.96	23.80%	111.24	-9.66%		2008-09	2,242.09	41.03%	193.57	-26.68%
2009-10	929.66	-25.03%	178.96	60.88%		2009-10	2,945.96	31.39%	386.50	99.67%
2010-11	1,346.81	44.87%	220.90	23.44%		2010-11	3,926.90	33.30%	468.59	21.24%
2011-12	1,824.77	35.49%	284.75	28.90%		2011-12	5,166.10	31.56%	520.05	10.98%
						2012-13	6,726.98	30.21%	624.10	20.01%
Profit Growth over 11 years			13.48	times		2013-14	8,476.19	26.00%	748.85	19.99%
Stock Price Appreciation over 11 years			21.05	times		2014-15	10,208.55	20.44%	1,022.85	36.59%
						Profit Growth over 14 years			48.49	times
						Stock Price Appreciation over 14 years			22.24	times

Sun Pharma and HDFC Bank are the two good examples of secular growth stories delivering stellar returns over the long term. We would like to draw attention to the growth in profits which was consistently high, year after year, and that led to these stocks delivering multi-bagger returns – 21.06 times for Sun Pharma (11 years) and 22.24 times for HDFC Bank (14 years).

CNBC's Definition of Cyclical and Secular Stocks

A company is cyclical if it needs a strong economy in order to perform well. Its fortune depends on the business cycle. Steelmakers like Nucor , machinery firms like Caterpillar and chemical companies like DuPont all fall into this category.

Secular, on the other hand, refers to companies whose growth remains consistent regardless of the economy. Typically they are manufacturers of foods, drinks, drugs and cigarettes. Some of the most recognizable household brands probably come to mind: General Mills, Coca-Cola , Procter & Gamble . These are classic recession-proof stocks that you to want own when the economy takes a dive because no one stops eating or brushing their teeth just because of a recession.

Reasons why Businesses are in Secular Growth

At base level, just by observing which companies are consistent performers; investors will be able to draw up a list of suitable companies for investing. If he/she wishes to probe deeper into the reasons why a company is in secular growth phase, many factors may come to light which will not only give the confidence to remain invested for the long term, but also provide an edge in identifying such companies in their early phase.

History has shown that the following are the 2 important characteristics of companies when they were displaying secular growth and delivering multi-bagger returns. One is external and the other is internal

Size of Opportunity (External)

Businesses cannot prosper in isolation. The market for their products and services should be huge or growing on a constant basis. Only then will the company be able to increase its topline and bottom-line. Generally, all companies in the industry will report good performance and investors will have a choice of companies to invest in. A rising tide will lift all boats. When Infosys was growing at 100 % annually, Wipro and Satyam were also improving their financial performance at similar pace. Steady expansion of the marketplace is a prerequisite for business therein to display secular growth.

Management Capacity (Internal)

Although the demand for company's products/services is rising rapidly, management will have to put in place capacity and systems to capture this growth. Factories / commercial infrastructure will have to be set up, marketing and supply network has to be expanded, back office has to be scaled up to handle higher volumes and balance sheet has to be carefully managed so that capital is deployed in a productive manner. These characteristics are internal to the company and investors may select companies which are better at these than their peer group within the same industry.

Every company which is in a secular growth phase will have these properties. By focusing on such companies, investors will be able reap extra-ordinary returns in their portfolio.

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