For Private Circulation

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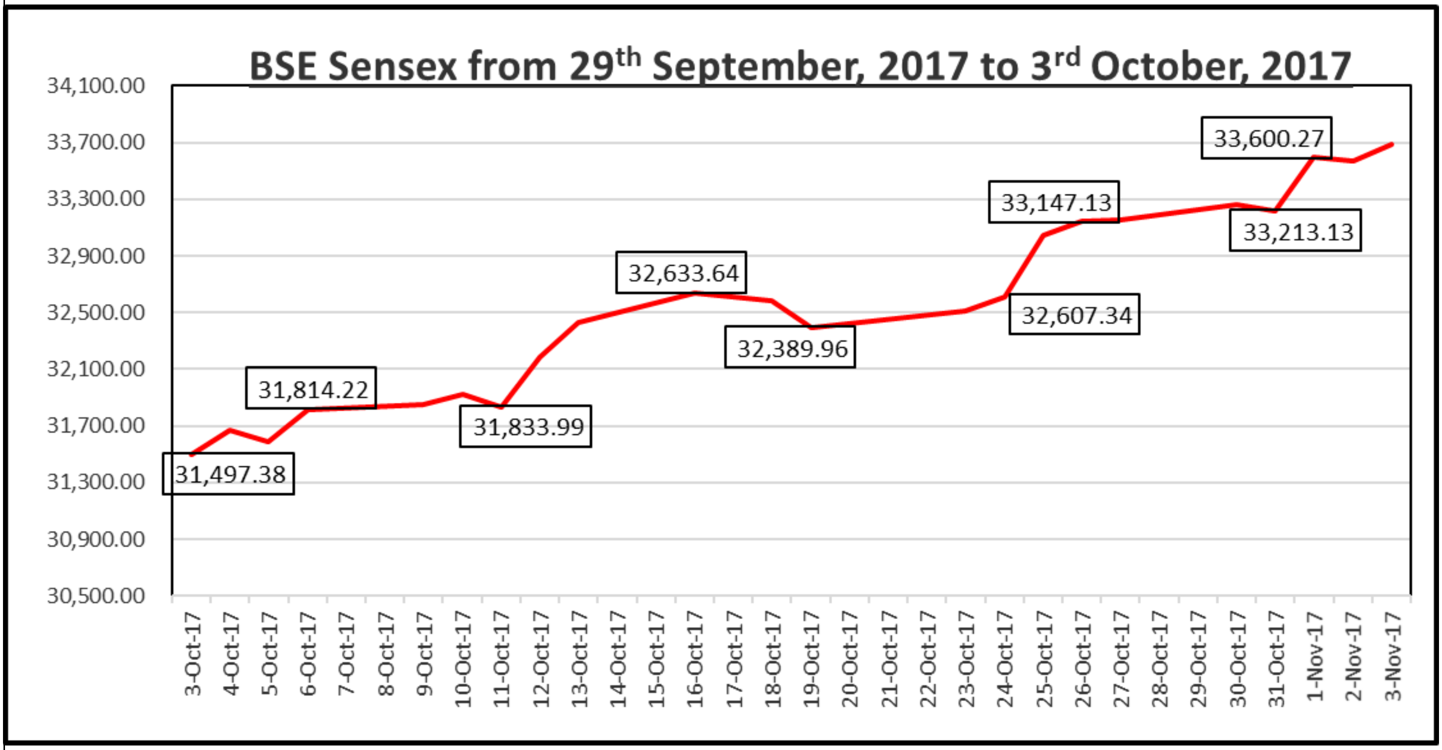
Multi-year Bull Market Gathers Momentum



Sensex at New Highs as Bull Market Resumes

After a mild correction in August and September, markets scaled to new highs in October with the Sensex rallying by 6.17 %. There were multiple triggers for this upswing. Firstly, the earnings season started on a positive note with large index companies delivering results in line or beating street expectations. Then there was the bold step on the part of the government to recapitalize PSU banks, which were dragging the economy, by restricting credit flow and finally, after two months of relentless selling, the FIIs turned buyer with net inflows of □1922.57 crores. Domestic institutional investors continued to pour funds into stocks with net purchases of□ 10,090.91 crores. Over the past 12 months, DIIs have invested a humungous □1,02,361.24 crores into the secondary markets and have been the bulwark of this extended up move.

Concerns over Economy Wane

The weeks prior to this month, many pundits had expressed fears over a slowdown in the economy due to GST related issues. A poor reading of 5.70 % for GDP growth rate for the June quarter confirmed that assessment. However, the earnings releases for September quarter and more importantly, optimistic management forecast allayed these fears. The consensus view now is that September quarter may still show stress but December quarter onwards we should see an uptick in GDP growth rates.

Blue Sky Scenario

With growth concerns out of the way, this bull market seems unstoppable. We are witnessing a '*blue sky*' scenario and apart from high valuations, there are no major concerns. Political stability, pro-active reform oriented government, favorable monsoons, benign inflation, enormous pool of domestic savings gravitating towards equity, early signs of pick up in capex cycle (roads, power transmission, renewable energy), high business confidence and stable currency are a few of the positive factors driving this multi-year bull market. In addition, there is a global *risk-on* trade with equity markets, from Tokyo to New York scaling new peaks. All of this makes a heady cocktail for releasing the animal spirits in the bulls who are on rampage.

Explaining High PE Multiples

We are challenged to find risk factors and although we are apprehensive of high PE multiples, our experience has been that high valuations do not induce a bear market. Just as rock bottom valuations are not catalysts for bull markets, stocks do not slide just because PE ratios are high. As we search for answers to explain high valuations, the only logic we can offer is that in times of minimal uncertainty, such as at present, investors discount earnings even further into the future. Normally, when a stock's target price is derived, it is based on FY18 or FY19 earnings. It appears that investors are now discounting earnings beyond FY19. The assumption is that earnings will increase in FY20 and beyond thereby justifying a very high PE multiple for more recent earnings.

A glimpse of this trend was evident when Goldman Sachs, in a recent research report, on Avenue Supermarket, justified a Buy recommendation by discounting its FY29 earnings. Avenue Supermarket is the world's most expensive retailer with a PE multiple of 114 times its trailing 12 months EPS. While discounting earnings 11 years into the future is a stretch, there is no denying that investors and analysts are working around present high valuations by looking even further into the future. They have that discretion because of very low macro and micro risk factors. The simple reasoning is that the more certain the future earnings and cashflows, the higher the valuation.

While we understand this phenomenon, history has taught us that risk factors in equity markets never disappear. Just because there are no visible perils does not mean that none exist. A googly or a black swan event which can derail this bull market cannot be ruled out. Once the fear of earnings creeps in it does not take long for PE multiples to contract.

Market View

In our previous newsletter, we had exuded confidence amidst a mild correction and the rebound which followed was as per our expectation. However, we would like to be cautious at these levels. In our opinion, investors should hold back their purchases and wait for meaningful corrections to re-enter. At this juncture, we are reminded by the words of wisdom from the great Oracle of Omaha Warren Buffet who said that "*Be Fearful When Others Are Greedy and Greedy When Others Are Fearful*".

The returns of the portfolios managed by us are as under:

Date From	01/10/2017	01/08/2017	01/05/2017	31/10/2016	01/11/2015	01/11/2014	01/11/2012
	1MONTH	3 MONTH	6 MONTHS	1 YEAR	2 YEAR	3 YEAR	5 YEAR
Elixir Equities Portfolio Performance (avg for all clients)	3.69%	2.31%	10.46%	19.03%	18.52%	17.99%	22.34%
SENSEX	6.17%	2.10%	10.89%	19.55%	13.95%	9.76%	12.89%
NIFTY	5.58%	2.52%	11.05%	20.51%	15.42%	11.11%	13.69%
Out / UnderPerformance	-2.48%	-0.21%	-0.59%	-1.48%	3.10%	6.88%	8.65%

This week we present an article – "Safety in Numbers" which analyses the importance of peer comparison.

Dipan Mehta

Safety in Numbers

Reviewing Peer Performance

A very interesting concept which could act as a guiding principle or check list item is performance review of peers. There is a growing trend to select stocks by following a bottom up approach. This stock selection strategy focusses on the strengths and weaknesses of the company in question and analyses its prospects more or less in isolation. External variables are considered but greater cognizance is given to the enterprises' inherent advantages, management quality, competitive edge and track record.

This system of stock selection has worked very well for professional investors but small retail investors are at a disadvantage because of inadequate information flow or ability to understand the business. In such a scenario, a key question which they can ask when considering an equity investment is

"How are others in the same industry faring?"

If the answer to this question is in the affirmative then it should build confidence in that stock.

Most Players in an Industry Share Similar Fortunes

The underlying premise is that if company A in a particular industry is doing well, chances are that others in that industry may also be going through good times. The converse is also true when the trend turns negative for the sector. The point of caution is when an investor is considering investing in a company when other players / competitors are stressed. It is not often that a company is doing well when its peer group is not and that is why for investors, there is '**Safety in Numbers'**.

If all or most companies are outperforming then selecting one or more within that sector based on unique aspects of that business may be a sound strategy. Contrarily, investing in a company when others in that industry are challenged is a risky one.

Early Signal for Investment / Divestment

This concept, when extended, may also provide an early signal in in identifying stocks for investing or for exiting a long term holding. If an industry is undergoing trying times for the past few years and then suddenly, one company within that sector reports a good performance, investors should quickly focus on that industry. The chances are that many more winners may emerge from that sector. The opposite may work in selling a stock. If a company in an industry, which has been on the upswing, starts disappointing on the financial front then it is a warning sign that trends in that industry have turned negative and investors must start to trim their positions in that sector even though other companies may still be reporting decent performances. It is only a matter of time before their financials begin to worsen.

A perfect example of this situation was when Sun Pharma announced a disappointing performance for December 2016 quarter on 13th February 2017. The BSE Healhcare index was at 15,076 on that day. Over the next 6 months, that index lost 15.56 % as most companies reported very disappointing results. Up until that point, pharma was an outstanding wealth creator for investors.

We have tested this hypothesis in the underlying tables and the outcomes are quite interesting.

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Sector	Housing Finance Companies						
Company	Year End>	201703	201603	201503	201403	201303	201203
LIC Housing	NP >	1,931.01	1,660.75	1,386.17	1,317.23	1,023.24	914.23
	% change	16.27%	19.81%	5.23%	28.73%	11.92%	
	Year End Price>	615.65	490.40	437.25	235.70	224.95	263.05
	5 year returns	134.04%					
HDFC	NP >	7,442.64	7,093.10	5,990.14	5,440.24	4,848.34	4,122.62
	% change	4.93%	18.41%	10.11%	12.21%	17.60%	
	Year End Price>	1,502.40	1,105.55	1,311.25	883.80	825.75	673.60
	5 year returns	123.04%					
Indiabulls Housing	NP >	2,842.38	2,294.12	1,978.23	1,510.00	1,227.91	
	% change	23.90%	15.97%	31.01%	22.97%		
	Year End Price>	997.30	646.75	557.70	236.40		
	3 year returns	321.87%					
Dewan Housing	NP >	1473.94	729.8	621.92	530.42	443.75	306.72
	% change	101.96%	17.35%	17.25%	19.53%	44.68%	
	Year End Price>	367.00	196.20	232.95	109.78	81.33	119.23
	5 year returns	207.81%					

Historic Data Confirms Trend

In the table above for housing finance companies, their profitability and share price movement was in an upward trajectory. Returns variance was on account of NP change.

This is true across sectors as can be seen from the adjoining table when they

There will always exceptions to this rule. Professional investors will be able to identify these but from a retail investor's view point, relying on external advice and investing with limited knowledge, this simple checklist of comparing with other companies in the same industry is a *Smart Investing* strategy.

Dipan Mehta

Software Industry 5-year period from FY2009 to FY2014		
Company	Compounded NP Growth	Compounded Stock Returns
Infosys Technologies	11.87%	19.88%
TCS	31.59%	51.12%
Wipro	20.05%	29.80%
HCL Tech	51.79%	51.79%
Cement Industry 4-year period from FY2009 to FY2013 / CY2008 to CY2012		
Company	Compounded NP Growth	Compounded Stock Returns
Ultratech Cemco	26.67%	35.69%
ACC	5.05%	31.51%
Gujarat Ambuja	5.10%	30.31%
Shree Cement	11.46%	60.18%
Tyre Industry 4-year period from FY2011 to FY2016		
Company	Compounded NP Growth	Compounded Stock Returns
MRF	62.46%	55.33%
Apollo Tyres	53.33%	21.86%
Ceat*	55.07%	124.34%
JK Tyres*	52.08%	59.91%
* 3 years		