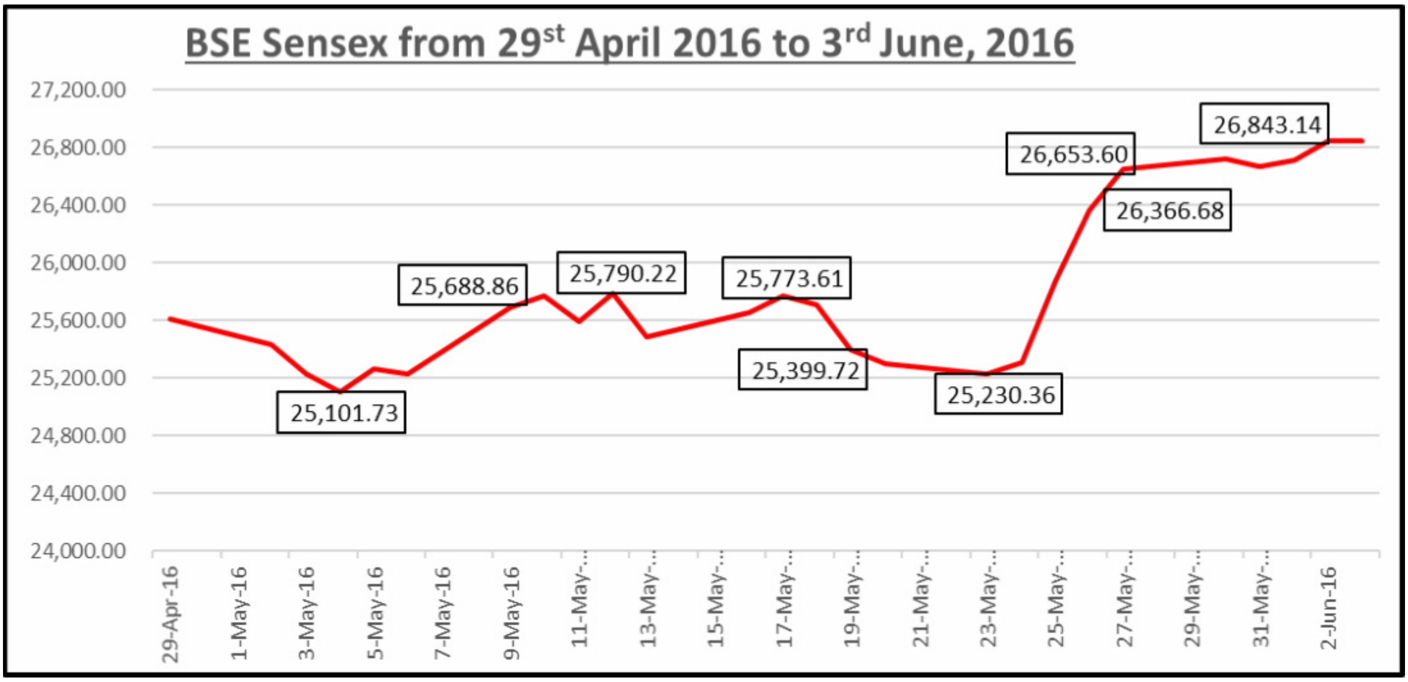
ELIXIR EQUITIES PRIVATE LIMITED

For Private Circulation ***3rd June, 2016***

Revival of the Bull Market in May?



Bull Market Revives in May

May turned out to be a great month for equites. The BSE Sensex rallied by 4.14 % as foreign and domestic institutional investors bought shares to the tune of Rs. 2,412.27 crores and Rs. 7,142.75 crores respectively. The sentiment in the market improved significantly and it does appear that Dalal Street is on a take-off mode.

The reasons for the rally, remain the same as were discussed in our previous newsletter:

1. Above normal monsoon outlook
2. Prospects of an interest rate cut post monsoon
3. Strong possibility of the passage of the GST Bill after recent state elections
4. Stable global markets
5. Cyclical upswing in corporate profits

Positive Factors turn More Bullish

The important change from April is that these positive variables have turned even more bullish over the past few weeks. Consider the facts:

Bountiful Monsoons

1. The second forecast of the Indian Meteorological Department (IMD) reiterated its earlier projection of a bountiful monsoon at 106 % of the average rainfall. More notably, it placed the possibility of a drought at less than 1%. This optimistic outlook of the IMD is shared by private forecasters as well, but one small piece of news which did catch our eye was a statement by the Australian Weather Bureau. They said that *'The strongest El Nino in nearly 20 years, which damaged crop production in Asia and caused food shortages, has ended…'*. It also predicted that *'…the chance of La Nina is at 50 percent'*. According to weather pundits, the El Nino (negative) effect lasts for 2-3 years and conversely, the La Nina (positive) effect also remains for the same period. If this were to be true, not only the 2016

monsoon, but the next 2-3 monsoons may also be above average and that is great news for India, where the rural economy is a growth driver.

ELIXIR EQUITIES PRIVATE LIMITED

Lower Interest Rates

2. The consensus call amongst economists is that post monsoons, if the outlook for food prices is benign, there is scope to cut interest rates by ¼ to ½ percentage. This would give a further boost the economy, which is already on a higher growth path, as was evident in the 7.9 % GDP growth rate declared for the March quarter.

GST a Reality in Monsoon Session

3. Another topic of discussion, in recent times, post the recent state elections, is the chances of the passage of the GST Bill in the Rajya Sabha. Congress, the principal opponent of GST, has been decimated in the elections and therefore their numbers are likely to fall when the Rajya Sabha elections take place for 55 seats in June. With greater representation of the NDA and the regional parties in the Upper House, the prospects of the GST becoming law has significantly improved and that augurs very well for the economy and stock markets.

Global Markets and US Interest Rates

4. Global markets were broadly stable during the month. There was a minor turmoil when US Federal Reserve's April meet minutes were released on 18th May. The minutes revealed that majority of the members of the Federal Reserve were of the view, that if the upcoming economic data was supportive, then, at their June meeting, they would consider raising interest rates. A rate hike in lending rate in the world's largest economy is negative for emerging markets (EM) such as ours. Global fund flows are then attracted to the safety of the US bond markets rather than EM equities. There was correction in the Sensex and Nifty when this news came out but as soon as world financial markets stabilized, these losses here were quickly recuperated over the next few trading sessions. The latest googly in this saga is the May non-farm US payroll data, which was a disaster. Only 38,000 jobs were added as against an expectation of an addition of 1,62,000 jobs. This negative data has put a big question mark on whether the Fed will go ahead with a rate hike in the face of a weakening labor market. We have observed that FII flows pick up whenever there is calmness in overseas stocks and commodity markets. We are of the view that although there will be uncertainty till the Fed meets on June 14-15; post this event, irrespective of the outcome, world financial markets will steady and our markets will continue to outperform.

Great Earnings Season

5. Earnings for the March quarter were a pleasant surprise. With the exception of PSU banks, almost all sectors did very well; beyond street expectations. According to us, this earnings season marks the turning point for corporate profits. These had been lagging, since the bull market began in September 2013 (when Narendra Modi was selected as PM candidate). Tepid growth in profits had been holding back this bull market and it does appear that after this earnings season, this major hurdle has also been overcome. History suggests that one good quarter leads to another and the momentum continues to build. Based on this, our outlook for the rest of the year is very optimistic.

Our Outlook on Stocks

In our earlier newsletter we had clearly articulated our bullish outlook, which we reproduce hereunder:

> '*We have been positive in our outlook for equities for the past two months and the trends discussed above have only increased our conviction to increase allocation to stocks. Investors must proactively develop a long term strategy for equities. Not only are we optimistic on equites but also view the present time as most opportune for investors*.'

We maintain this positive view on stocks and apart from a monsoon failure or an unforeseen negative global event, the next 3 months could be very exciting for investors and traders. We would advise increasing allocation to equities without compromising on the quality of portfolio.

ELIXIR EQUITIES PRIVATE LIMITED

Coincidently, the topic of this month's Smart Investing Series is *"**Maintaining the Quality of Portfolio**"*. In this article, we discuss the long term benefits of keeping a close watch on the quality of stocks an investor should buy and keep in his / her portfolio.

The average returns generated by the portfolios under our management are as follows:

				ANNUALISED RETURNS AS ON		03/06/2016	From
Date From	**04/05/2016**	**04/03/2016**	**03/12/2015**	**04/06/2015**	**04/06/2014**	**04/06/2013**	**05/06/2011**
	1MONTH	**3 MONTH**	**6 MONTHS**	**1 YEAR**	**2 YEAR**	**3 YEAR**	**5 YEAR**
Elixir Equities Portfolio Performance	**3.00%**	**11.26%**	**3.32%**	**8.08%**	**19.80%**	**23.27%**	**16.96%**
SENSEX	**6.44%**	**9.26%**	**3.79%**	**1.05%**	**3.52%**	**8.61%**	**5.76%**
NIFTY	**6.16%**	**10.09%**	**4.66%**	**2.19%**	**4.90%**	**10.42%**	**6.31%**
Performance comparison	**-3.44%**	**1.17%**	**-1.34%**	**5.89%**	**14.90%**	**12.85%**	**10.65%**

Dipan Mehta

SMART INVESTING – VIII
- Maintaining the Quality of Portfolio

This discussion on '*Maintaining the Quality of Portfolio'* is an extension of the earlier one in the previous newsletter, which was the *'Portfolio Approach to Investing'*. In that series, we had discussed the advantages of creating a balanced portfolio of stocks which was appropriate and suitable to the profile and temperament of the investor. In this chapter, we shall discuss the benefits of maintaining the quality of the portfolio.

Classifying Stocks based on Quality

Before we proceed, it is important to understand that apart from segregating stocks as large, mid and small caps, another vital classification is into top, medium and low quality. This segmentation is qualitative and quantitative. Qualitative aspects are generally its corporate governance standards such as the

- size and eminence of the board
- size and profile of their auditors; have they appointed a big 4 audit firm?
- transparency of investor communication
- corporate actions such as dividends distributed, bonus rights splits etc.
- nature of its industry especially the quantum of cash transactions involved
- competitive intensity within the sector
- lifestyle of the promoters

Quantitative aspects which may be considered are

- its past track record - Has it been consistent and better than its peer group?
- the strength of its balance sheet especially the level of debt *vis-à-vis* equity and its earnings capacity
- credit rating
- industry growth rates and
- operating profit margins (higher the better)

A top quality company will score on most qualitative and quantitative parameters whereas the opposite is true for a poor quality one. Depending upon the above mentioned criteria, investors must classify stocks based on their quality.

ELIXIR EQUITIES PRIVATE LIMITED

Advantages of Investing in Quality Stocks

The endeavor should be to create a superior quality portfolio and avoid the temptation of buying into poor quality stocks just because they are the flavor of the month. The advantages of creating and maintaining a quality portfolio are manifold:

1. In times of turbulence, quality stocks will fall comparatively less than poor quality ones and that will keep the conviction of the investor to be invested in equities. A common folly is to panic during a selloff and liquidate holdings at a loss. However, in a falling market, if the portfolio is less impacted then the fear factor is low and the investor will be able to tide over the bear markets. That in itself is victory, because he / she will then be able to ride the bull market.

2. There are umpteen examples of quality stocks delivering outstanding returns over the long term. In this context, we are reminded of a very profound quote by legendary investor Warren Buffet on his stock selection philosophy:

   "It's far better to buy a wonderful company at a fair price, than a fair company at a wonderful price."

   If only investors were to follow this mantra, then their success is assured.

3. Owning quality companies becomes a matter of pride for the investor and that builds conviction to remain invested for the long term. Invariably, these quality companies are well known for their products and services and may even be household names. They will be able to withstand the volatility in stock prices which affect all stocks. It is easier to accept a 15-20 % fall in HDFC Bank rather than a similar fall in JP or DLF or GVK / GMR. There is strong belief that the likes of HDFC Bank will eventually bounce back whereas the poor quality companies mentioned may just not recover and the loss will be permanent.

4. Poor quality companies are more prone to scams and scandals. Such companies are also targets of market manipulators and therefore subject to intense speculation and volatility. In India, there have been many instances of disappearing companies or investors fooled by market operators. The anguish that investors feel in this aftermath makes them completely averse to stock investing and that is detrimental to them and the economy at large. The best way to avoid this situation is to keep the company of good quality companies.

Avoid Dilution of Quality in Bull Markets

The tendency to dilute the quality of portfolio is highest in a bull market as quality companies, which have been steadily rising even in bear and sideways markets may not have the spectacular moves of poor quality companies which have corrected significantly or stagnated during that time. Greed may force the investor to dump their quality holdings, as they are not moving fast enough, and invest the proceeds into companies which have a dodgy track record but are temporarily stealing the show. Such a switch is fatal and will impact long term returns for investors. It may even result in massive loss in the portfolio when markets tank. A disciplined approach to stick to quality stocks is a winning formula and a *Smart Investing* tool.

Dipan Mehta